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Business Charts

Significant Tax Cases of 1959

Accounting in the Paint Industry

Recommendations on the Income Tax Act

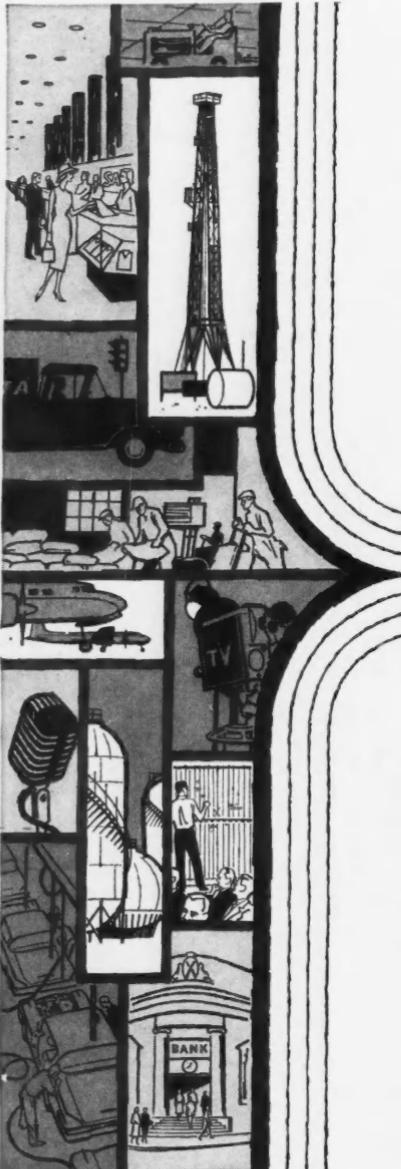
The Industrial Accountant in the Modern World

Financial Statements for Farmers

ACCOUNTING RESEARCH: Consolidated Financial Statements

TAX REVIEW: Personal Corporations (contd.)

PRACTITIONERS FORUM: Conferences and Continuing Education



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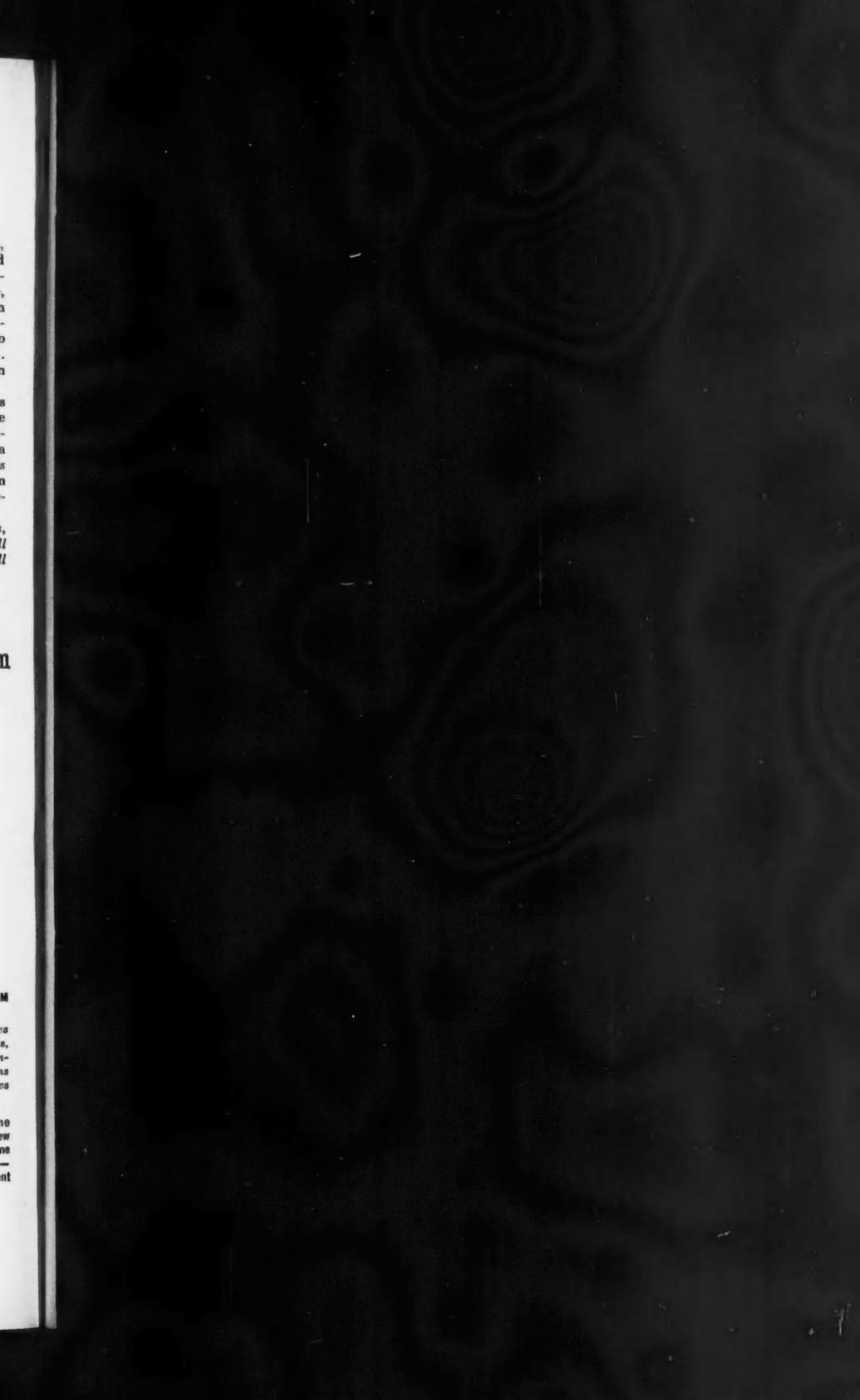
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THE CANADIAN
**CHARTERED
ACCOUNTANT**

VOLUME 76, No. 3

MARCH 1960

EDITORIAL

Professional Ethics	227
An Important Enquiry	229

ARTICLES

The Role of the Industrial Accountant in the Modern World	231
<i>C. Geoffrey Edge, R.I.A.</i>	
Significant Tax Cases of 1959	238
<i>J. G. McDonald LL.M. & D. A. Ward</i>	
Business Charts	247
<i>Thomas J. Diggory</i>	
Accounting in the Paint Industry	256
<i>Arthur W. Walker, C.A.</i>	
Financial Statements for Farmers	263
<i>Alan W. Bell, C.A.</i>	
Recommendations on the Income Tax Act	269

DEPARTMENTS

Accounting Research	288
Practitioners Forum	294
Current Reading	298
Tax Review	303
Students Department	309

MONTHLY FEATURES

In This Issue	212
Notes and Comments	218
News of Our Members	316
Institute Notes	317
Correspondence	323
Sweetness and Light	324

The Canadian Chartered Accountant, March 1960. Published monthly by the Canadian Institute of Chartered Accountants. Chairman, Editorial Board, H. S. Moffet, F.C.A.; Editor, Kenny Englebert; Asst. Editor, Jean Vale. Advertising Representative, E. L. Vetter. Editorial and Business office: 69 Bloor street east, Toronto 5. Subscription rates: \$6 a year; 60 cents a copy. Printed by General Printers Limited and mailed at Oshawa, Ontario. Authorized as second class mail by the Post Office Department, Ottawa. Opinions expressed are not necessarily endorsed by the Canadian Institute.

IN THIS ISSUE

C. G. EDGE, R.I.A. (page 231)

In "The Role of the Industrial Accountant in the Modern World", C. Geoffrey Edge discusses how the accountant can assist in the internal management of an industrial company. The years immediately ahead will see great changes in the industrial accounting field, and new techniques in analyzing costs and appraising expenditures will play an ever increasing part in arriving at management decisions. The author examines the function of the industrial accountant, his relationship to operating managers and his contribution to effective management.

Mr. Edge is assistant treasurer of Chemcell Limited. He was formerly engaged in work connected with the financial and economic aspects of the chemical operations of Canadian Industries Limited and subsequently became manager of the Financial Analysis Department of Canadian Chemical & Cellulose Co. Ltd. He is a director of the Montreal Chapter of the Society of Industrial & Cost Accountants.

J. G. McDONALD, LL.M. and D. A. WARD (page 238)

The relationship between business and taxation is of such vital interest to businessmen and tax administrators that we asked John G. McDonald and David A. Ward to prepare a comprehensive summary of "Significant Tax Cases of 1959". In carrying out their assignment, they have selected those cases which they consider to be of sufficient importance to serve

as examples for future tax planning. In some instances the cases have been limited to the position taken in the lower court, and readers should bear in mind that a review in a higher court may, at a later date, reverse such rulings.

Mr. McDonald practises law with McCarthy & McCarthy, Toronto and is a member of the British Columbia and Ontario Bars. He is a lecturer on income tax at Osgoode Law School and contributes "Your Taxes" column which appears regularly in *The Financial Post*. He is the author of "Canadian Income Tax" and "Cases on Income Tax".

Mr. Ward is also with McCarthy & McCarthy and a member of the Ontario Bar. He graduated from Queen's University in 1954 and from Osgoode Hall Law School in 1958.

T. J. DIGGORY (page 247)

Just as punched holes are the "language" of punched card equipment and binary code is the "language" of electronic computers, so are charts the common language of those who are required to analyze the endless stream of information dealing with every phase of a company's operations. A simple graph will often highlight trends which could not be readily noticed from a study of raw statistics, and in "Business Charts", Thomas J. Diggory outlines many of the areas to which charting techniques can be usefully applied and some of the most commonly used types of graphic presentation.

The author is a manager in the management controls department of Peat, Marwick, Mitchell & Co., Toronto, with whom he has been associated for the past five years. He is an associate member of the Chartered Institute of Secretaries, the Association of Certified & Corporate Ac-

(Continued on page 214)

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(Continued from page 212)

countants, the Institute of Cost and Works Accountants and the British Institute of Management. His last article on "Control of Warehouse Costs" appeared in *The Canadian Chartered Accountant*, February 1959 issue.

A. W. WALKER, C.A. (page 256)

Paint-making technology is continually undergoing change, and major improvements in the chemistry of finishes and production methods are being made. Such constant advances in product and procedure require careful and accurate accounting methods, and in "Accounting in the Paint Industry" Arthur W. Walker discusses aspects of costing which are peculiar to an industry which uses such a variety of individual commodities in its overall production. Mr. Walker's article fulfills our need to publish, from time to time, material dealing with specialized industries.

The author is associated with the Brantford, Ontario, office of Glendinning, Campbell, Jarrett & Dever. He became a chartered accountant in 1953 and is a member of the Institute of Chartered Accountants of Ontario.

A. W. BELL, C.A. (page 263)

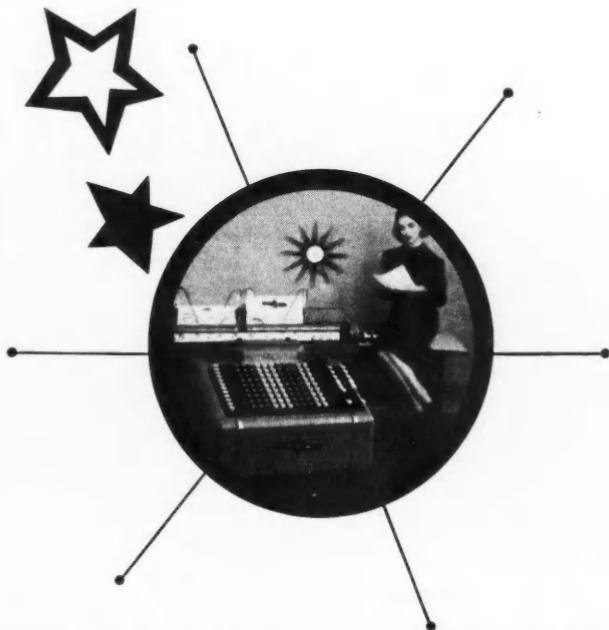
The taxation of farm income presents many problems to the professional accountant, particularly in Western Canada, and in "Financial Statements for Farmers" Alan W. Bell discusses one of these, namely the accounting problem which presents itself when financial statements are prepared on an "accrual basis". The author backs up his argument with a "live" example and has used as a guide statements taken from Accounting Research Bulletin No. 43 issued

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(Continued from page 214)

by the American Institute of Certified Public Accountants and the principles discussed in Bulletin No. 10 of the Canadian Institute of Chartered Accountants.

Mr. Bell is a partner in Williams, Tanner, Bell & Watkinson, Lethbridge, Alberta. He became a chartered accountant in 1945 and is a member of the Institutes of Chartered Accountants of Quebec and Alberta.

EDITORIAL (page 227)

This month's guest editorial on "Professional Ethics" has been written by Peter Wright, Q.C., a lawyer who, in recent years, has made an extensive study of this subject. Certain rules of professional conduct can be written down, but, in the main, it is left to the conscience and sense of responsibility of the individual accountant to maintain the esteem in which his profession is held by the public. In the author's own words, "The challenge of today and of the future is not in the field of rules of conduct but in that of ethics themselves. In a society which has enclosed so much of its life in business and commerce, the relation of right and wrong and human purpose to commercial practices is vital."

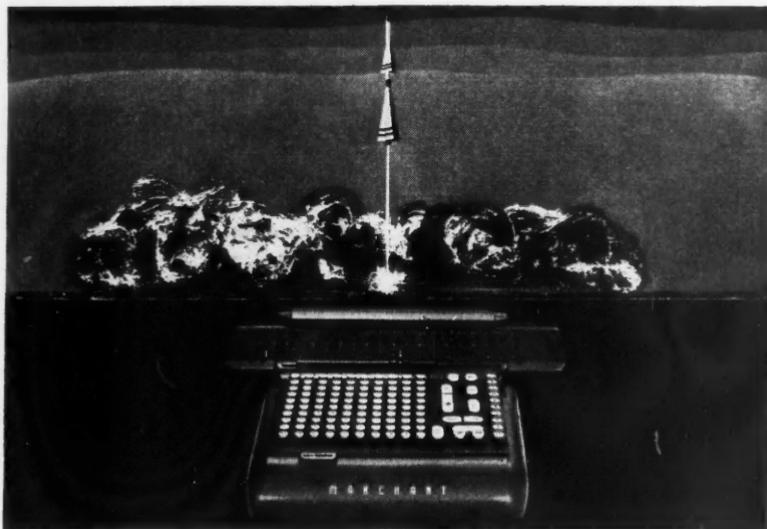
Mr. Wright is a partner in the legal firm of Wright & McTaggart, Toronto and was called to the Bar in 1934. Many readers will remember his article "Chartered Accountancy as a Profession" which he wrote in the CCA December 1958.

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NOTES AND COMMENTS



A. Maxwell Henderson Named Auditor-General



The appointment of Andrew Maxwell (Max) Henderson, O.B.E., C.A. as Auditor-General of Canada was announced in Ottawa on February 1 by Prime Minister Diefenbaker.

Mr. Henderson will assume the position on March 1, replacing Watson Sellar who retired last August. He will have to resign from his present job as chief financial officer for the Canadian Broadcasting Corporation in order to take over the \$20,000-a-year position.

Born in England, Mr. Henderson came to Canada at an early age and worked with Crowell, Balcom & Co., Halifax from 1924 to 1929 when he obtained his certificate qualifying him as a chartered accountant. He then joined Price, Waterhouse & Co., in Toronto for five years before becoming comptroller of Hiram Walker Gooderham & Worts Limited in Walkerville.

From 1946 to 1956 he was secretary-treasurer of Distillers-Corporation Seagram's Limited, Montreal and director of all its Canadian and foreign subsidiaries except those in the United States. During World War II he was on loan to the Federal Government as chief of the manufacturing section on the Foreign Exchange Control Board, and also as assistant to the chairman and comptroller of the War-

time Prices and Trade Board. He was president of the Association of Canadian Distillers from 1949 to 1954 and during the 1950-56 period was a member of the council and chairman of the foreign trade committee of the Canadian Chamber of Commerce. He was chairman of the Chamber's executive council in 1957.

He is a member of the Institutes of Chartered Accountants of Nova Scotia, Ontario and Quebec, a member of Council of the Quebec Institute, and chairman of the Institute's Public Relations Committee.

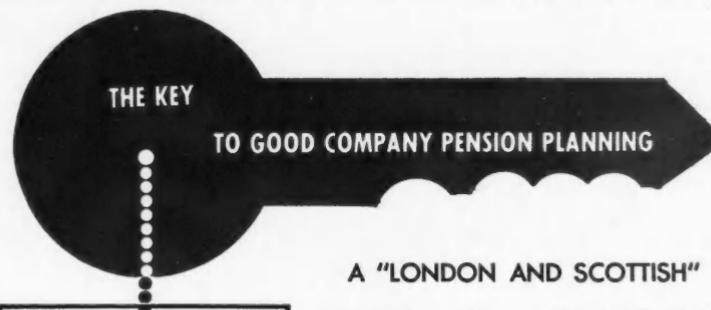
Tax Appeal Board Hearings

Effective February 1, a change in procedure in connection with appeals heard *in camera* has been announced by Tax Appeal Board chairman Cecil L. Snyder. In his statement, the chairman pointed out that in the past the practice has been for the name of the appellant to be substituted by a number. The place where the appeal was heard, as well as the names of those called to give evidence and any other information which might in any way identify the name of the appellant, remained undisclosed in an effort to give him complete anonymity.

Explaining the Board's present position, chairman Snyder said that substantial reasons have arisen which have caused the Board to review this practice. "Appeals are coming before the Board in ever-increasing numbers each year and, as may be well understood, the appeals are becoming more and more complicated. In recent judgments the difficulties encountered

(Continued on page 220)

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(Continued from page 218)

by members of the Board have been pointed out when endeavouring to explain facts and circumstances of an appeal heard *in camera* when the judgment was being prepared and written *in camera* form. With these additional appeals ever pressing upon members of the Board for attention, it was realized that the preparation and writing of judgments *in camera* form was taking far too much time in comparison to the time required to deliver a judgment in the ordinary form. Still another reason was that in certain instances it seemed almost impossible to write a reasonably understandable judgment when so many material items had to remain undisclosed."

For these reasons the Board has decided to discontinue the practice of writing *in camera* judgments and effective with February sittings, appeals will continue to be heard *in camera* in the courtroom when the appellant so requests but the judgment to follow will not be *in camera* as in the past. The Board's statement continues:

"Judgments remaining to be prepared in all appeals heard *in camera* up to the end of 1959 will be rendered in accordance with the former practice. However, in all appeals to be heard from this date forward the name of the appellant will appear in the written report of the judgment as well as the names of the counsel or agents acting or participating on behalf of the appellant or the Minister of National Revenue. The practice of reporting judgments under a number with relevant material omitted will be discontinued forthwith.

"In the future when appeals are heard *in camera* in the courtroom or other place of hearing there may be occasions when the publication of certain intimate details might be embr-

rassing to an appellant or might be injurious to his reputation, his welfare or his business. These may well be omitted although the name of the appellant, whether the appellant be an individual or a corporation, and all necessary relevant matters will be contained in the judgment in the same manner as is done in judgments delivered by the learned judges of the Exchequer Court of Canada when appeals are heard *in camera* in the Exchequer Court pursuant to section 102 of the Income Tax Act."

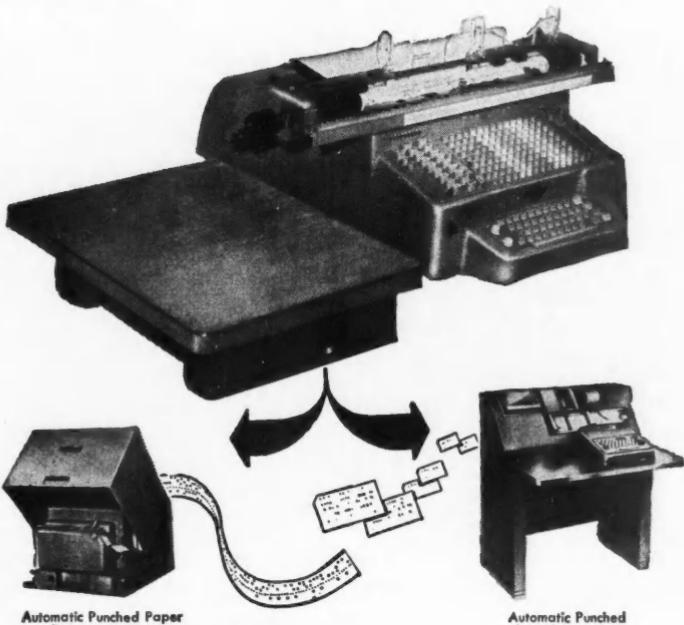
Programs for Executive Training

Because of the complexity of the problems encountered by management today, and the consequent demands made on their skills, more and more executives are taking time off to attend intensive short training programs now being given by several universities in Canada.

From March 14 to 26 the University of Alberta is holding its seventh annual course in executive development at the Banff School of Fine Arts. The course is open to men and women from 25 to 45 who have normally had some years executive experience. Subjects on the curriculum are management and administration, corporation investment and finance, financial and administrative controls, and human relations. The fee is \$300. Further details may be obtained by writing the Director, Banff School of Fine Arts, Banff, Alta.

The Graduate School of Business Administration (Ecole des Hautes Etudes Commerciales) of the University of Montreal is giving an executive training program from May 29 to June 11 designed for business leaders and heads of departments. Using the case method technique, registrants will study human relations, marketing, finance and control, business

(Continued on page 222)



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(Continued from page 220)

policy and elements of administration. Cost of the course is \$550, and further information is available from Professor Jean Deschamps, Director, Executive Training Program, Ecole des Hautes Etudes Commerciales, 535 Viger Ave., Montreal 24, Que.

Queen's University School of Commerce and Business Administration plans to expand its executive program for 1960 by offering a total of four courses and conferences. An executive summer school from July 10 to 30 will be inaugurated to provide broad training in general management to middle-level men between the ages of 30 and 55 and will cover the subjects of administrative action, production management, financial management and control, and marketing management. Fee is \$600.

Queen's annual one-week confer-

ence "Perspective for Management" will also be held in 1960 from May 30 to June 3 and will deal with problems of planning, organization, direction, coordination and human relations. Also intended for middle and senior-middle management, this course costs \$300.

A three-day income tax seminar from May 27 to 30 will be offered again this year by Queen's University, for a fee of \$150.

For further information about any of the Queen's courses, write G. R. Post, School of Commerce and Business Administration, Queen's University, Kingston, Ont.

The management training course offered by the University of Western Ontario will run from July 31 to September 2 and is designed for men over 35 with successful administrative experience to assist in the further de-

(Continued on page 226)

DATES WORTH NOTING IN 1960

MAY 27-28 Spring Meeting of the Executive of the Canadian Institute of Chartered Accountants, The Chantecleer, Ste Adele-en-Haut, Que.

MAY 29-31 Spring Meeting of the Council of the Canadian Institute of Chartered Accountants, The Chantecleer, Ste Adele-en-Haut, Que.

SEPT. 11-14 Annual Meeting of the Canadian Institute of Chartered Accountants, Banff Springs Hotel, Banff, Alta.

* * *

JUNE 16-17 Annual Meeting of the Institute of Chartered Accountants of British Columbia, University of British Columbia and Vancouver Hotel, Vancouver, B.C.

JUNE 16-17 Annual Meeting of the Institute of Chartered Accountants of Alberta, Macdonald Hotel, Edmonton, Alta.

JUNE 19-21 Annual Meeting of the Institute of Chartered Accountants of Ontario, Queen's University, Kingston, Ont.

JUNE 21-22 Annual Meeting of the Institute of Chartered Accountants of Quebec, University of Montreal, Montreal, Que.

JUNE 23-24 Annual Meeting of the Institute of Chartered Accountants of Nova Scotia, Isle Royale Hotel, Sydney, N.S.

* * *

MAY 22-26 41st International Conference of the National Office Management Association, Queen Elizabeth Hotel, Montreal, Que.

JUNE 27-29 National Conference of the Society of Industrial and Cost Accountants of Canada, Queen Elizabeth Hotel, Montreal, Que.



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Enrolment: To ensure the greatest benefit for the participating students the enrolment will be limited to the first 60 applicants.

Application Forms: Now available and will be mailed on request. Only applications made on the prescribed forms will be considered.

Completed forms must reach the Students Association by March 18, 1960

Inquiries should be addressed to the Chartered Accountants Students' Association of Ontario, 69 Bloor Street East, Toronto 5, Ont.

(Continued from page 222)

velopment of their managerial skills. The main subject is the policy problems of the administrator, with Canadian cases as lead-offs for discussion. The fee is \$900. W. A. Thompson, Director, Management Training Course, University of Western Ontario, will be glad to supply further details on request.

Twelve universities and institutions in the Atlantic Provinces are sponsoring the executive development course being given by the Atlantic Summer School for Advanced Business Administration in Halifax from June 19 to July 23. Offered for a fee of \$850, the course is aimed at people with five to ten years experience in management. Subjects include human and labour relations, cost and financial administration, administering productive activities; marketing administration and strategy. Here again the case method is used. For further details, application should be made to Dean H. E. Dysart, P.O. Box 1321, Halifax, N.S.

Committee Meetings

A sub-committee of the C.I.C.A. Committee on Accounting and Auditing Research met on February 8 and 15 in Toronto to discuss the forthcoming brochure for bankers. Chairman of the meeting was H. R. Macdonald.

Under the chairmanship of F. T. Denis, the Annual Conference Committee met on February 16 in Toronto to make plans for the technical program of the 1960 C.I.C.A. annual conference to be held in Banff in September.

Citizenships Granted

Certificates of Canadian citizenship were granted to 326,304 residents of Canada over the period 1953-58, ac-

cording to figures released by the Dominion Bureau of Statistics in a report entitled "Characteristics of Persons Granted Canadian Citizenship, 1953-58".

Over half (57%) of these persons resided in Ontario at the time of their application, 17% in Quebec, 14% in the Prairie Provinces, 11% in British Columbia, and just over 1% in the Atlantic Provinces. Almost 85% resided in urban areas, and almost 66% in metropolitan groups.

Males exceeded females by 64,000, and almost three-quarters of the total of both sexes who were over 15 years of age were married.

Almost one-sixth, or just under 54,000 of the total, were former citizens of Poland. The next largest group (37,127) were Italian nationals, followed by 35,518 former citizens of Commonwealth countries, 32,591 former nationals of Germany, 28,688 Netherlands citizens, and 21,796 U.S.S.R. citizens.

In the News

GEORGE S. CURRIE, C.A. (Que.), president of Bowater Corp. of North America, was elected president of the executive board of the Canadian Pulp and Paper Association.

CURRENCY EXCHANGE RATES

The following nominal rates of exchange are supplied by The Canadian Bank of Commerce, International Department, Head Office, Toronto, as at 4 p.m., Jan. 29, 1960:

Australia (pound) .214%; Belgium (franc) .0192; Denmark (kroner) .1385; France (franc) .1950; Germany (d. mark) .2295; India (rupee) .2010; Italy (lira) .00155; Mexico (peso) .0766; Netherlands (guilder) .2535; New Zealand (pound) 2.67%; Norway (kroner) .1340; Sweden (kronor) .1845; Switzerland (franc) .2210; Union of South Africa (pound) 2.67%; Sterling in Canada, 2.66%-2.67%; sterling in New York, 2.80-2.80%; U.S. dollars in Canada, 4%-4% discount.



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Professor John R. E. Parker, C.A. will direct the Review Course, assisted in the lecturing by Mr. David H. Bonham, C.A., and Mr. Maurice W. Vance, C.A.

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Editorial

PROFESSIONAL ETHICS

AT THE OUTSET OF considering the subject of professional ethics, it is important to understand the difference between ethics and professional ethics. Ethics have been a matter of philosophical debate from the earliest times and are defined in the Shorter Oxford English Dictionary as "the science of morals". They involve our fundamental point of view with regard to the problems of right and wrong, and the purpose of our lives. Professional ethics are not only a particular and limited aspect of the whole problem of ethics, but they deal specifically with rules of conduct. The dictionary includes as one of its meanings of ethics "the rules of conduct recognized in certain limited departments of human life", and it is in this sense that the professions are specially concerned with ethics.

Having made this distinction, we must remember that as human beings we should always be concerned with ethical problems. Why are we alive? What is the purpose of our life? What is right? What is wrong? By what standards shall we be judged? By what standards shall we judge others? Experience shows that it is possible for a time and sometimes for a lifetime to avoid consideration of these problems. We can take refuge from them in alcohol, physical exercise, faith or superstition, ceaseless activity and in many other ways, but many human beings are faced with them all their lives, and the responsible leaders of thought and men can scarcely avoid them. Plato in his *Apology* put into Socrates' mouth the words: "Daily to discourse about virtue and of those other things about which you hear me examining myself and others is the greatest good of man. The unexamined life is not worth living." In our professions and in our lives, we are faced with these problems. We cannot lead unexamined lives and profess what we do in our working days.

In the professions we have a further and particular duty. That is to define for ourselves and for others the standards and rules of conduct which unite us together in our profession. In many pro-

fessions in modern days, these come ready-made. In others they have to be created in the light of what is professed by the members of a calling working together. Thus in every true profession there are rules of conduct, some unwritten, and some written and enforced by sanctions. These rules of conduct are one of the powerful factors in building and maintaining a professional group.

Both aspects of the question of ethics are at the very heart of the profession of chartered accountants.

Chartered accountants in our modern society are the every day custodians of the businessman's conscience. Judges, lawyers and ministers may in various aspects become involved with it but not in the same way as an accountant who, on the one hand, is concerned continually with a variety of small ethical problems and, on the other hand, finds himself faced from time to time with business problems, sometimes of frightening size, which should be solved in terms of right and wrong. The chartered accountant has faced these problems in the past. The way in which this has been done is the root of the growth of this profession and of its future. It maintains a living code of ethics in modern business society.

One of the ways in which chartered accountants have sought to build their profession and to face the broader ethical problems is to define in rules of professional conduct how they will conduct themselves and what the character of their role will be, based on independence and integrity. These rules are the professional ethics of the group. They helped to create it and to bind it together, and they serve now as a guide to all members of how they should conduct themselves.

From the early days of the profession it appears that ethics were taken for granted and that professional ethics, the professional conduct of the new group, was what had to be defined and enforced.

That situation has changed. Now the profession is not only strong enough to regulate the relations of its members among themselves, but there is general agreement on professional ethics and on the way in which members should conduct their affairs.

The challenge of today and of the future presented to the profession is not in the field of rules of conduct but in that of ethics themselves. In a society which has enclosed so much of its life in business and commerce, the relation of right and wrong and human purpose to commercial practices is vital. Society can look to the professions for leadership, and in the forefront of the professions directly related to business are the chartered accountants.

In this and every generation, the young have been seeking answers to the questions that are involved in ethics. If the professions are to continue to attract those they need, they must appeal in ethical terms. A profession that merely offers money and status in the community will not attract the best.

It is the ethical basis of a profession on which its future will be built. The constant consideration of right and wrong conduct in business and in the profession is the way to establish it. No professional people should lead unexamined lives, and none are more practised in the technique of examination than chartered accountants.

AN IMPORTANT ENQUIRY

THE REQUEST WHICH the Honourable Leslie M. Frost, Premier of Ontario, made in May 1958 to Walter L. Gordon, F.C.A. to accept the chairmanship of a committee to examine the administrative and executive problems of the Government of Ontario, in all divisions of the Provincial Service, has resulted in a report which should be of considerable help and interest to everyone concerned with the organizational structure of government and the basic principles that apply to it. Released in January, it covers 467 pages and is the first survey of its kind in Canada. In addition to Mr. Gordon, the committee consisted of Dr. W. A. Macintosh, C.M.G., principal and vice-chancellor of Queen's University, and C. R. Magone, Q.C., a former deputy attorney-general, and it recommended a wide range of changes in the organizational structure of the government, many of which will undoubtedly command a full measure of support.

Throughout the report, the committee laid stress on four principles: ministerial responsibility, financial accountability, grouping of related functions, and provisions for appeals. A major recommendation of particular interest to the accounting profession concerns the control of expenditure by the Treasury Board. The committee favours a plan whereby there is early and continuous liaison between government departments and other agencies and the Treasury Board as programs are formulated and begin to take shape; and further, that the duties now assigned by statute to the Budget Committee, comprising senior departmental officers, be re-assigned to a full-time staff directly attached to the Treasury Board. It is suggested that the present Budget Committee be retained but that, in future, it should act in a purely advisory capacity to the Treasury Board.

A number of general recommendations were made on departmental organization with particular emphasis on the Departments of Municipal Affairs and of Planning & Development. Clarification is suggested as to the lines and limits of authority of various government boards and commissions. In some cases, their practices and processes should be modified; in others, their duties and responsibilities to the government should be redefined. A case for granting freedom to those who come under the jurisdiction of these boards and commissions to appeal against their decisions is a compelling one, par-

ticularly as such decisions may affect the livelihood of thousands of men and women. In the matter of reporting to the Legislature, the committee points out that there seems to be no consistent reason why reports are called for on some occasions and not on others and suggests that all boards and commissions, with the exception of advisory boards, be required to prepare annual reports on their activities and table them in the Legislature.

The committee was helped greatly in its work by obtaining a detailed appraisal of the organizational and operational structure of the 20 government departments and 85 boards and commissions. Four-fifths of the report deal with this information which was prepared by two firms of chartered accountants and two firms of management consultants. The committee acknowledges the help it received in this regard and suggests that, with the continued growth of government, publication of such reviews be carried out at regular intervals.

The report of the Committee on the Organization of Government in Ontario is probably the most comprehensive and fully documented description available of a provincial government's administrative structure and is further proof, if any is needed, of the many public duties which, nowadays, are borne by members of the accountancy profession.

The Role of the Industrial Accountant in the Modern World

C. GEOFFREY EDGE, R.I.A.

THE ROLE of the industrial accountant in a large multiplant company is to assist operating management make rational decisions about the future. Therefore, a brief review of the objectives of business and the function of management is useful before proceeding to a more detailed discussion of how the industrial accountant achieves his aims, what concepts and techniques he uses, what he requires from the accounting system and what his relationships are with operating personnel.

This article does not discuss the work of other accountants in industry. It excludes all reference to the important role of the corporate accountant in relation to external statements, taxation, auditing and the whole framework of what may be called "legal-financial" accounting.

Function of Management

Since the end result of the industrial accountant's efforts is information and advice to operating management, a perspective of his work needs to encompass the functions of management, the nature of its problems and the way its decisions are made.

No longer is it widely accepted that the sole purpose of business is to maximize profits. Rather, the objec-

tive is the creation of demand by providing products and services which customers need at prices which they are willing to pay. This must be accomplished in a changing and competitive climate in which profits are adequate to attract capital and consequently perpetuate the business.

The two main features of this philosophy are predetermination of the desirable objectives for a business and achievement of these objectives through planning and control. Objectives are needed, not only for marketing and productivity, since survival depends on the elimination of waste and inefficiency, but also for man-power, physical and financial resources, and the broader social and community aspects of business. Survival in the changing world also dictates the need for research into and development of new products and processes. Having established its policies, management makes comprehensive plans for their attainment and controls operations by measuring deviations from the plan, identifying their causes and taking corrective action to regain the planned course.

Operating Management Problems

The industrial accountant should not only be familiar with manage-

ment techniques but should also understand the business if he is to render competent advice.

In merchandising, complex problems often arise on short and long-term pricing, optimization of product-mix, desirability of "spot" business, effectiveness of marketing effort in each area, and location of distribution facilities.

In production, problems relate to yields and efficiencies, elimination of waste, quality control, effectiveness of maintenance, production scheduling and the effective utilization of labour and equipment.

For capital expenditures, decisions are required on whether to make or buy, what type of equipment to purchase, whether to replace equipment this year or not, whether to expand, and whether to introduce newer and more efficient equipment.

From the internal financial viewpoint, information is needed on what funds are expected to be generated, and what the requirements for cash are likely to be for working capital, capital expenditures, and other uses.

Nature of Decisions by Operating Management

The above examples illustrate the broad areas where operating management is constantly making decisions, either for the long-term or on a day-to-day basis. These decisions will usually be made whether an industrial accountant renders advice or not. The aim of the accountant is to ensure that information is available for making them on a scientific basis, eliminating bias and reducing the need for intuition and judgment.

There are several reasons why the industrial accountant, by virtue of his

knowledge and training, can assist management in decision-making:

1. Management needs to identify problems requiring attention. Accounting statements often bring them to light.
2. All decisions relate to the future. The industrial accountant can offer his knowledge of forecasting techniques and projections of past data.
3. Most decisions involve the choice between alternatives, and the economics of each are often measured through accounting data.
4. The quality of decisions can be improved by replacing guesswork and judgment with measurement. Accounting data often forms the starting point for the information needed to measure the effect of changes.
5. The generally accepted scientific basis for arriving at a decision is to define the problem, get the facts, draw a conclusion and test the answer. The ingenuity and skill of the industrial accountant in quantitative analysis can help in this regard.
6. Management is often short of time in reaching decisions. Hurried choices can be avoided by asking the industrial accountant to make the analysis and render a report.
7. Information used for decisions often needs interpretation. Management thinks in terms of "cause and effect". The effects often show up as figures in the accounts, and the industrial accountant needs to dig behind the figures to find out what "caused" them to be what they are.
8. Finally, decisions can be made more easily by operating manage-

ment if the information is written in readily understood language and is geared to the problem at hand, and a short and logical report can lead to conclusions designed to get action. The industrial accountant is trained to provide this type of assistance.

Criteria for Decisions

The criteria for evaluating objectives and on which to base decisions are undoubtedly the profit of a business and its return on investment. Since these are both "financial" in nature, the industrial accountant can be of special assistance to operating management in their application.

The dollar provides a common measuring device by which diverse activities in different departments in a company can be integrated. Profit directs the efforts of each part towards a common goal. Return on investment ensures that results are expressed in a similar manner to that used by the owners of the capital invested in the company.

What is a desirable return on investment is not, however, a simple matter to decide. Short-term benefits can often be obtained to the detriment of long-term advantages. A return on investment sufficiently high to ensure survival of the business in the long run is essential. This is easier to conceive in theory than determine in practice. The experience and judgment of senior management are needed here.

Furthermore, return on investment as a concept is not automatically applicable to all facets of a business. Although it is the ultimate yardstick, others related to it, such as the ratio of profit to sales or the ratio of sales to investment, are needed for various

aspects of the business. Moreover, most businesses are complex, and different parts inter-act on one another. Consequently, a variety of relationships are important, for example, inventories of finished goods in relation to the number of weeks supply, production as a percentage of capacity, selling expense in relation to sales, and maintenance costs in relation to type, capital cost, and age of equipment. Only when data is related to other factors, significant relationships are established and all parts are geared to return on investment, is effective control established. The industrial accountant has a special responsibility in developing data on these relationships and reporting it to management.

Costs cannot be defined without relating them to the purpose for which they are required. Different costs concepts are used according to whether short or long-term problems are being studied, whether the problem is one of cost control, or whether it relates to a decision about the future. Management often needs guidance from the industrial accountant on what cost concepts should be used, since a decision on an incorrect basis could be detrimental to the business.

Role of the Industrial Accountant

It will be seen from the foregoing that the role of the industrial accountant in the collection, analysis and interpretation of quantitative data is an essential part of management planning and control. His job is to organize and administer the accounting function in order to assist management in establishing a plan to attain objectives and in making rational decisions for achieving the planned result. At senior levels, this is often called "controllership".

Cost Concepts and Techniques

Cost and industrial accounting is developing rapidly. This is partly the result of the advancement of scientific management and the need for better and faster information on which to base decisions, and partly because industrial accountants have developed newer techniques which blend economic concepts with accounting data.

COST ACCOUNTING SYSTEM

Management problems take innumerable forms, and an accounting system to fit them all would be hard to find. The system should not only produce cost and earnings statements which will satisfy the broad needs of planning and control, and corporate accounting, but also should be sufficiently flexible to be a source of basic data that can be fitted in different ways to different particular needs.

In designing such a system, the industrial accountant would be familiar with the main features of costing for raw materials, labour and manufacturing expense, as well as their distribution to finished production. He would ensure that the system such as process costing or job costing was adapted to his own industry and company. He would have a knowledge of mechanization, systems and procedures, and statement design.

FINANCIAL PLANNING

Long-term forecasts, annual budgets and short-term forecasts covering a period of a week, month or quarter are all part of the framework of financial planning. It is designed to give operating management a forward picture of what funds are likely to be generated, the size and nature of outlays for the capital expenditure program, and the flow of funds throughout the organization.

BUDGETARY CONTROL

As indicated earlier, the cardinal feature of management lies in formulating objectives, making plans to achieve them and comparing progress against plan. This is often called "budgetary control".

A budget is a plan generally covering a period up to a year to attain stated objectives. The objectives are usually related to return on investment to measure their adequacy. A budget would cover all phases of a business, such as sales, costs and earnings, as well as capital expenditures, inventories, cash flow and balance sheets.

The budget provides a means of co-ordinating functions and planning profit. It ensures that energy is not dissipated in expanding sales volume and product lines which do not raise profitability, that standards of production are established so that workers do not spend an exorbitant amount of time doing jobs to perfection regardless of cost, and that supervisors do not play safe by expensive overstocking without being aware of the penalty in doing this.

The budget also provides a medium of control, since accounting statements are arranged to show comparisons of actual results with those budgeted. This is reinforced by reporting, on the exception principle, the deviations from plan which have occurred and taking corrective action as appropriate.

The industrial accountant is usually responsible for the organization and administration of the planning and control function, and often establishes formal procedures for this. He enlists the support of senior management since, without it, planning has little chance of success. He pro-

motes an understanding of the purposes and uses of budgets throughout the organization, encouraging each manager to participate in proposing a budget for his part of the organization. Since each manager is accountable for deviations, he should play a major role in formulating the plan. Each manager is given information needed to prepare the budget, and to compare actual results with it. Assistance in interpreting results is also usually part of the service provided.

RESPONSIBILITY ACCOUNTING

The development of the concept of responsibility accounting represents an important advance in control over operations. In this approach, the account classification is designed so that each manager is given information only on those costs which he can control. Allocated costs are excluded. Since control is achieved through people and not things, it is enhanced if accounting statements comparing actual with planned results are given to the persons who are in a position to take corrective action. When accounting statements are stripped of the complexities of allocated costs, they become simpler and more readily understood by operating personnel.

STANDARDS, STANDARD COSTS AND FLEXIBLE BUDGETS

Standards, standard costing, and flexible budgets play a dominant role in most cost accounting systems today. They are related to the philosophy of "management by objectives" mentioned earlier, and the concern of management in eliminating waste and inefficiency. Standards of performance in production areas are usually established by industrial engineers. The physical standards,

which are themselves control devices, are translated into standard costs. These costs form the basis of budgeting and forward estimating and are also the foundation for comparing the reasonableness of actual performance. A method of analyzing the "causes" of variances of actual from standard usually forms an integral part of the standard cost system. Flexible budgets are a variant of standard costs. They indicate what the standard costs should be for different levels of production and allow for "semi-variable" costs of production.

DIRECT COSTING

Direct costing, which is designed for improved internal management control, is gaining wide acceptance. It is particularly effective when used in conjunction with standard costs. In this system, standard costs are restricted to costs directly variable with the level of production, and variances from standard in each period are charged directly to the earnings statement. In addition, those costs which do not vary with the level of production but with a period of time, often called "fixed" costs, are also charged directly to the earnings statements each month without going through inventories. These are costs which are considered to arise from being in business and should be charged to earnings, whether the productive capacity is used or not. Only variable costs are considered to be "product" costs. Advantages include a greater understanding of earnings statements by operating managers, better control because variances from standard or budget appear in the earnings statement in the same period as they occur, and a greater appreciation of the effect of changes in sales

volume on earnings from the short-run viewpoint.

Much has been written about break-even analysis and profit-volume relationships. Essentially, they require a separation of costs into variable and fixed. These classifications are essentially relative, since what is variable and what is fixed depend on the time period involved. Nevertheless, this separation of costs does permit the evaluation of many problems. It shows, for example, the level of sales at which operations would only break even and, therefore, is a measure of the vulnerability of a business to loss of sales volume. It provides data for determining what opportunities for sales exist providing spare capacity is available and long-term prices are not prejudiced. So long as prices are sufficient to cover variable costs, earnings in the short run will increase. In addition, information is generated which is useful in solving product-mix problems, since sales value less the variable cost per unit provides an indicator of relative profitability of each product.

Marginal costing and differential costing are names for similar approaches of separating fixed and variable costs to solve merchandising and production problems. Essentially, management decisions are based on "change" from a given situation and an appraisal of the effect of the "change". This approach can be seen in the treatment of joint products and "opportunity" costs.

The treatment of joint products is different from the viewpoint of managerial decisions needed to solve problems compared with that of cost accounting. In cost accounting, to produce earnings statements and inventory values, costs need to be

assigned to each product. This is often on the basis of weight or relative sales value and is based on expediency rather than on logic. No such limitation is imposed for managerial decision, and all of the joint products can be regarded as one entity and the total impact of changes in sales, costs and earnings used for arriving at a decision.

"Opportunity" costing is a technique often used and which has been borrowed from the economists. The opportunity cost concept is that the cost of using any service is the net gain which could be derived from the next best alternative use. For example, if the alternative to using product A in the manufacture of product B is to sell it elsewhere for 10c a pound, then the cost of product A in making product B is 10c a pound. In other words, once it has been established that it is economic to sell product A, then the question of deciding whether to use it to make product B is based on the net gain over and above the sales revenue of product A, if it were to be sold. Almost all business decisions involve alternatives; therefore, opportunity costs play a major role in these decisions.

PRODUCTION SCHEDULING

There is a tendency for inventory control and production scheduling to be carried out in terms of physical quantities, regardless of the impact on return on investment. The industrial accountant can often provide a useful service by indicating the "cost" of holding inventories and relating solutions to return on investment.

ANALYSIS OF DISTRIBUTION COSTS

The industrial accountant can perform a useful service through the analysis of distribution costs by re-

placing judgment and opinion by measurement. Often data on the distribution costs incurred on servicing small orders, or analyzing the cost incurred on one product compared with another, or in different markets, can lead to a major change in marketing strategy.

APPRAISAL OF CAPITAL EXPENDITURES

From the long-term viewpoint, an important area in which the industrial accountant can assist is in the appraisal of capital expenditures. This would include advice on the different methods of appraisal, ensuring that the correct cost concepts were used, that supporting facts were adequate, and that the presentation was logical and concise. Subsequently, he can aid in the control over disbursements and in the post-appraisal of completed projects.

LONG-TERM PRICING

Long-term pricing introduces a further aspect. Normally, it is based on full costs of production plus a reasonable rate of return on investment. However, the perennial problem of inflation often results in different dollar standards being used for parts of historical balance sheets. It would be more usual in long-term pricing decisions to use replacement values for assets rather than depreciation based on historical cost.

TREND ANALYSIS

Finally, costs which are often classified as "fixed" in the short run can be varied by management decision in the long run. A constant appraisal of trends in these costs can be of help.

Relationship to Others

Although technical proficiency with figures is often considered the main attribute of the industrial accountant,

his skill in human relations is even more important. His work brings him in daily contact with most members of the organization. His ability to get along with people, to get his ideas across, to talk the language of the sales manager, production manager and engineer spell the difference between success and failure.

The role of coordinating planning and control brings the industrial accountant in close contact with the "staff" functions of market research, industrial and process engineering and production scheduling. His primary role, however, is to serve "line" management whether in production, sales or development. His task is to ensure that "line" managers have the financial facts so that they can "plan and control" operations and "decide" on the best course of action. The industrial accountant does not automatically have the right to render advice in this field. He must earn it by establishing confidence in his ability, integrity and impartiality, and by his sympathy and understanding for the operating point of view.

Conclusion

The viewpoint expressed here is that the industrial accountant exists to serve operating management. He should become imbued with management thinking about problems of planning and control, and of ways in which decisions are made. Because of this orientation in outlook, he administers the accounting function and develops techniques and concepts so that only the information needed by management is compiled, that it is presented in a manner that is readily usable by the level of management concerned, and that it is adequately analyzed and soundly conceived.

Significant Tax Cases of 1959

J. G. McDONALD, LL.M. AND D. A. WARD

ONE OF THE PROBLEMS in presenting a summary of the leading developments in the field of taxation is that the sheer volume of the subject defies logical collation in a short article. A review of tax cases is very much like the critic's comments on the telephone book: the story as a whole is weak, but the cast of characters is impressive.

The following comments are, it is hoped, a reasonably logical summary of the more important tax developments of 1959. We have also taken the liberty of adding our own comments.

Procedural Problems

(a) When is an Assessment "made"?

In No. 590¹ the Tax Appeal Board decided, with reference to the four-year limitation period of section 46(4), that the Minister may reassess tax within four years from the date of the original assessments, but notice of such reassessment need not be mailed to the taxpayer within four years from the date of mailing of the original assessment. The Board held that an assessment of tax is the calculation of the amount of tax by the assessor, and as long as the calculation has

been completed within the four-year period, the assessment is in time although notice of the reassessment may be sent to the taxpayer at a later date. It follows from this that the "day of the original assessment", which is the commencement of the four-year period, is not necessarily the date which appears on the original notice of assessment. In Departmental practice, the original notice of assessment is normally prepared on a day which may be seven to ten days earlier than the date which appears on the notice. It is therefore necessary to inquire carefully into the actual date of the calculation of tax both for the original assessment and for the reassessment whenever the reassessment is made close to the end of the limitation period.

Because No. 590 empowers the Minister to reassess tax without providing the taxpayer with notice of reassessment within the four-year period, there is an obvious need for clarification of section 46(4) by amendment.

(b) What is an Income Tax "Return"?

The preparation of income tax returns normally consists in the regular completion of the form of return

¹ 59 D.T.C. 51; 21 T.A.B.C. 163.

which is provided by the Department of National Revenue. Section 44(1) requires that corporations and individuals shall file a return of income in prescribed form, but neither the Act nor the Regulations contains provisions which compel the taxpayer to complete a return in detail. This deficiency became apparent in the case of *The Queen v. Hart Electronics Ltd.*,² an appeal by way of stated case from the decision of a magistrate to the Manitoba Court of Appeal. The magistrate acquitted the accused on a charge of failing to file an income tax return on the ground that a sufficient return had in fact been completed and filed. The return contained no financial statement and was unsigned. The Court of Appeal held that because the return contained "certain information", the court was unable to interfere with the decision of the magistrate, and the Minister's appeal was dismissed. The court did not refer to section 130 of the Income Tax Act which requires that a return made by a corporation shall be signed on its behalf by one of the officers of the company.

Although it is doubtful that this decision will have a binding effect on other courts, it would appear that an amendment of the Income Tax Act or the Regulations is in order to clarify the basic information required in a return.

What Constitutes Income

(a) "Capital Gain" Cases

As in former years, the Tax Appeal Board and the Exchequer Court heard a great many "capital gains cases" in 1959 involving dealings in land or other real property. The

cases need not be discussed in detail as they constitute mere findings of fact in each case. It is noted that the Minister enjoyed success in most of the appeals which were decided. This may be attributed to two factors.

First, it appears that most cases where such profits have been taken into taxable income clearly involve "an adventure or concern in the nature of trade". The taxpayers' explanations of their motivation for the purchase of the lands and their ensuing sales are usually ignored. The court is more impressed by the fact that the taxpayer acts as though he purchased with the intention of reselling despite his protestations to the contrary.

Secondly, the Board³ has indicated that the onus placed upon a taxpayer in such an appeal is that he must prove that the assessment is erroneous beyond a reasonable doubt. We have always thought that, as in all civil cases, the onus of proof is to show that on the balance of probabilities the Minister has erred. The burden which seems now to be placed upon the taxpayer is the same burden of proof as that which the Crown bears in criminal cases.

The theory behind the heavy burden being placed on the Crown in criminal cases is that it is better that nine guilty men should go free than that one innocent man be convicted. We doubt whether such a theory ought to be applied between the Minister of National Revenue and the taxpaying public. It would mean that nine persons would be required to pay tax on capital gains for every income transaction that goes untaxed!

² Reported, 59 D.T.C. 1192.

³ See: *Verret v. M.N.R.*, 59 D.T.C. 531; 23 T.A.B.C. 24.

(b) *Windfall Gains*

The Tax Appeal Board in *German v. M.N.R.*,⁴ held that payments made to Alberta residents pursuant to the Oil and Gas Royalties Dividend Act of Alberta were not taxable receipts. The Minister had advanced the argument that the amounts were taxable as "dividends" under section 6(1)(a) (i) of the Income Tax Act. The Board held that although the amounts were called "dividends", they were gifts in essence. In the result, the taxpayer received a refund of \$6.60, and the Minister of National Revenue subsequently announced that he would reassess 860,000 returns to provide refunds for all Alberta taxpayers involved.

(c) *Capital Cost Allowance
"Recapture"*

During the year 1959, the Tax Appeal Board heard four cases⁵ involving the question of allocation of the sale price of a business among its constituent assets. In each case, the Minister had allowed nothing for goodwill and issued an assessment bringing into the income of the vendor recaptured capital cost allowances. In each case, the taxpayer successfully argued that the assessment was improper as the Minister had over-valued the depreciable assets and had under-valued goodwill. The Board looked to section 20(6) (g) and applied this subsection in varying the assessments.

(d) *Husband and Wife Income
Splitting*

On the question of family income

splitting, the Exchequer Court held in *Sura v. M.N.R.*⁶ that Quebec taxpayers are not entitled to file returns in which the husband and wife divide the earnings of the husband between themselves. The court held that even though the spouses may be subject to the community of property provisions of the Quebec Civil Code, the husband's earnings are not divided between husband and wife by the operation of the civil law for the purposes of the imposition of income tax.

The decision reverses the judgment of Mr. Fordham, and an appeal is expected to be taken to the Supreme Court of Canada for a final determination of the question.

In the United States, the courts have held that the combined income of the husband and wife is taxable one-half in the hands of each spouse when they are in community as to property. In order to preserve uniformity in the taxation of all individuals, the Internal Revenue Code now provides for the splitting of income between husband and wife for purposes of taxation. In the event that the Supreme Court of Canada should find that Quebec spouses are entitled to split their joint taxable income, we would expect an amendment to the Income Tax Act to place other taxpayers in a similar position or to bring Quebec taxpayers back to their former position.

(e) *Parent and Child Income
Splitting*

Again on the question of income splitting, in *Dunkelman v. M.N.R.*,⁷

T.A.B.C. 402 and *Gordon v. M.N.R.*, 59 D.T.C. 514; 22 T.A.B.C. 432.

⁴ 59 D.T.C. 420; 22 T.A.B.C. 302.

⁵ *Consolidated Laundry v. M.N.R.*, 59 D.T.C. 45; 21 T.A.B.C. 168, No. 636 v. M.N.R., 59 D.T.C. 333; 22 T.A.B.C. 171; *C. Peters v. M.N.R.*, 59 D.T.C. 474; 22

6 59 D.T.C. 1280; [1959] C.T.C. 460, reversing 57 D.T.C. 478; 18 T.A.B.C. 65.

⁷ 59 D.T.C. 1242; [1959] C.T.C. 375.

Mr. Justice Thurlow held that the word "transfer" as used in sections 21(1) and 22(1) of the Income Tax Act must be interpreted in the usual and ordinary sense of the word. When a person lends money to another, he does not normally say that he has "transferred" his money to another. The court therefore held that a loan of money to a trust for the benefit of children under the age of 19 years did not result in the attribution of the income of the trust to the lender, despite section 22(1). A similar result would follow with the loan of money to a spouse and investment of the proceeds of the loan by the spouse.

The Exchequer Court relied upon the case of *St. Aubyn v. Attorney-General*,⁸ where Lord Simonds said, "My Lords, I have no hesitation in saying that the payment of cash to a company upon a subscription for shares is not a transfer of property to the company. No one, lawyer, businessman or man in the street, was ever heard to use such language to describe such an act, and I decline to stretch the plain meaning of the words in an Act of Parliament in order to comply with what is said to be its purpose".⁹

⁸ [1952] A.C. 15.

⁹ It is interesting to speculate whether the *St. Aubyn* case would be persuasive authority in the Supreme Court of Canada in support of an argument that a sale for value is not included in the term "transfer" despite the decisions of Mr. Justice Cameron in *McLaughlin v. M.N.R.*, 52 D.T.C. 1074; [1959] C.T.C. 104 and of Mr. Justice Thurlow in *German v. M.N.R.*, 57 D.T.C. 1216; [1957] C.T.C. 291.

¹⁰ 59 D.T.C. 1008.

¹¹ 59 D.T.C. 1013.

Deductions, Expenses and Exemptions

(a) Deductible Expenses and Capital Expenditures

In three companion cases, *Bedford Overseas Freighter Ltd. v. M.N.R.*,¹⁰ *Halifax Overseas Freighter Ltd. v. M.N.R.*,¹¹ and *Falaise Steamship Co. Ltd. v. M.N.R.*,¹² Mr. Justice Dumoulin held that payments made by the appellants in order to cancel charterparty contracts were deductible expenses incurred for the purpose of producing income. The payments were made to avoid possible claims from the charterers of the taxpayers' ships based upon allegations that the vessels chartered were unseaworthy. The taxpayers also cancelled the charterparties to enable them to effect necessary repairs and subsequently recharter the ships at more favourable rates.

On the other hand, the Supreme Court of Canada in *Bannerman v. M.N.R.*,¹³ held that the costs incurred by the shareholder of a company in order to obtain a winding-up order were not deductible from the shareholder's income. The court held that the purpose of the winding-up proceedings was to remove the president from the control of the company and was not for the purpose of earning income from the shares.

A similar result was obtained in *M.N.R. v. Evans*,¹⁴ where the Exchequer Court held that legal fees incurred by the taxpayer in a successful attempt to convince the courts that she was entitled to an annuity

¹² 59 D.T.C. 1016.

¹³ 59 D.T.C. 1128; [1959] C.T.C. 214, affirming 57 D.T.C. 1249; [1957] C.T.C. 375.

¹⁴ 59 D.T.C. 1001; [1958] C.T.C. 362.

of \$25,000 a year for life from an estate were not deductible. The court refused to allow the deduction following the decision of the Supreme Court of Canada in *Dominion Natural Gas Co. Ltd. v. M.N.R.*¹⁵ and held that the expenditure was a non-recurring outlay made for the purpose of protecting an existing capital asset from extinction. Consequently it was an outlay on account of capital and barred from deduction by the provisions of section 12(1)(b). It is interesting to note that the Exchequer Court discussed the case of *Kellogg Co. of Canada Ltd. v. M.N.R.*¹⁶ but refused to follow that decision.

The Exchequer Court also dealt with the problem of when a repair becomes so sufficiently large as to amount to a replacement of capital. In *Haddon Hall Realty Inc. v. M.N.R.*,¹⁷ Mr. Justice Fournier held that the replacement of refrigerators, venetian blinds and stoves in an apartment building amounted to the replacement of subsidiary parts of the building as a whole, and the cost was therefore a maintenance expense.

(b) Hobby-Farm Losses

The question of hobby-farms was before the Exchequer Court in the case of *M.N.R. v. The Grieve Estate*.¹⁸ In that case, the deceased taxpayer had operated a fruit farm for many years in some of which he showed a profit. In 1953 and 1954, losses were incurred in the farming operation. During the same period,

enjoyed another source of income from his investments.

The taxpayer filed his returns claiming as a deduction from his investment income the full amount of the losses incurred in each year. The original assessments which he received indicated that this treatment was acceptable to the Minister. The taxpayer was later reassessed, the Minister making a determination under section 13(2) and disallowing part of the loss. The taxpayer argued that the Minister was not entitled to make such a determination as the original assessment was a determination for the purposes of section 13(2), and he was now *functus officio*. The Exchequer Court held that the preparation of an assessment of tax does not require a determination under section 13(2).

As a second ground of appeal, the taxpayer argued that his chief source of income was a combination of farming and some other source of income, and therefore he was not subject to the provisions of section 13. Mr. Justice Thurlow held that the taxpayer was not entitled to claim that his income was from a combination of farming and some other source because the other source of his income was entirely unconnected with farming operations.

The taxpayer might have argued in this case that his chief source of income was farming despite the fact that his farming operations resulted in a loss. The Supreme Court of Canada¹⁹ has indicated that the word "income" as used in the Income Tax

¹⁵ [1941] S.C.R. 19; [1940] 4 D.L.R. 657; 1 D.T.C. 499-133.

¹⁶ [1943] S.C.R. 58; 2 D.T.C. 601; [1943] 2 D.L.R. 62.

¹⁷ 59 D.T.C. 1145; [1959] C.T.C. 291. (An appeal to the Supreme Court of Canada is pending in this case.)

¹⁸ 59 D.T.C. 1186; [1959] C.T.C. 320.

¹⁹ See: *Interprovincial Pipe Line Co.*, 59 D.T.C. 1229; [1959] C.T.C. 339, reversing 59 D.T.C. 1018; [1959] C.T.C. 1.

Act does not always mean *net profit* or *loss* but may, if the context requires, be construed as gross receipts. If this interpretation can apply to the word "income" as used in section 13(1), then perhaps all is not lost for the bona fide farmer who also receives investment income.

(c) Foreign Tax Credits

This introduces what is perhaps the most interesting decision rendered during the past year: *Interprovincial Pipe Line Company v. M.N.R.*²⁰ In this case, the Minister refused to allow the taxpayer a full credit against tax of the amount of U.S. taxes withheld on investment income earned within the United States. The withholding tax was levied by the U.S. upon gross payments to the taxpayer at the rate of 15%. The Minister's assessment was based on the assumption that section 41 permits a credit only of the amount of tax which is imposed on that part of the taxpayer's *profit* which arose in the U.S. Therefore, the Minister deducted from gross receipts from U.S. sources that part of the taxpayer's interest expense which he considered referable to the earning of the foreign income. The cost in this case exceeded the revenue and no profit appeared. Therefore, no tax credit was allowed. Presumably, if any profit

had appeared, the taxpayer would have been allowed a credit of only 15% of the profit.²¹

The Supreme Court took strong issue with the Minister on this point and held that the Income Tax Act did not authorize the Minister to split up the taxpayer's expenses and attribute certain portions of costs to portions of revenue. The court also held that section 4 which provides that "income . . . from a business or property is the profit therefrom. . ." is not a definition of the word "income". It would, therefore, appear that the word "income" as used in the Act may sometimes mean "profits" and at other times mean "gross receipts".

Mr. Justice Locke in a separate judgment went further. He referred to section 139(1)(az)²² and held that this section could not apply to support the Minister's contentions. Mr. Justice Locke was of opinion that the section is authority for the proposition that a taxpayer is not entitled to consolidate profits and losses of two separate businesses in the same year. We agree with Mr. Justice Locke on this point, but since the 1952 amendments were made to section 13, such consolidation has been permitted by most assessors.²³ Section 139(1)(az) was enacted as a companion to section 13 of the 1948 Income Tax Act

²⁰ 59 D.T.C. 1229; [1959] C.T.C. 339, reversing 59 D.T.C. 1018; [1959] C.T.C. 1.

²¹ See, *Van der Voort v. M.N.R.*, 58 D.T.C. 252; 19 T.A.B.C. 126.

²² S. 139(1)(az): "A taxpayer's income from a business, employment, property or other source of income or from sources in a particular place means the taxpayer's income computed in accordance with this Act on the assumption that he had during the taxation year no income except

from that source or those sources of income and was entitled to no deductions except those related to that source or those sources."

²³ Two cases were reported in 1959, both involving assessments for years later than 1952 where the Minister refused to allow the taxpayer to consolidate business losses with other income earned in the same year: *Fregot v. M.N.R.*, 59 D.T.C. 487; 22 T.A.B.C. 418; *No. 657 v. M.N.R.*, 59 D.T.C. 526; 23 T.A.B.C. 7.

which provided that "the income of a person for a taxation year shall be deemed to be not less than his income for the year from his chief source of income". In 1952, section 13 was amended to provide solely for the disallowance of hobby-farm losses, but no amendment or repeal was made of section 139(1)(az). This section, although it now stands alone, is adequate authority for the non-consolidation of losses and profits.

(d) Personal Corporations

In 1959 the Exchequer Court affirmed Mr. Fisher's decision in the appeal of *Settled Estates Ltd. v. M.N.R.*²⁴ Here Mr. Justice Cameron held that when the controlling block of shares in a personal corporation passes to the executors of the principal shareholder under a will which makes no provision for wife or children, the company ceases to be qualified as a personal corporation. The court held that the executors (here an individual and a trust company) were not "an individual" within the meaning of section 68(1)(a). The judge indicated that "an individual" must be a natural living person capable of having a family, and personal representatives of the deceased do not so qualify. In this case, both Mr. Fisher and Mr. Justice Cameron overlooked the effect of section 63(2) under which an estate or trust is "deemed to be 'an individual' in respect of the estate or trust property". In the *Settled Estates* type of case the property of the estate would include the shares of a corporation.

Accounting Principles and Practice

In *Canadian General Electric Co. Ltd. v. M.N.R.*,²⁵ Mr. Justice Cameron had occasion to consider the problem of the timing of tax on income earned

through fluctuations in the value of foreign exchange. The taxpayer borrowed a sum of United States dollars and, after a number of years, repaid the loan at a time when U.S. dollars were at a discount. The taxpayer admitted that the profits were taxable but claimed that because accounts were kept on an accrual basis, the income ought to be spread over the term of the loan by making a calculation at the end of each year to bring into income, year by year, accrued profits resulting from the exchange fluctuations. The court disagreed and held that the profit was not realized until the year in which the debt was repaid. Therefore, the profits all fell to be taxed within the one year.

Statutory Amalgamation

In 1959, section 105C was enacted presumably for the purpose of preventing taxpayers from taking advantage of provincial Companies Acts which provide for statutory mergers in a manner which resulted in the tax-free stripping of surplus from companies. Dividend stripping through vertical mergers involves for example:

(1) Sale by A of his shares in surplus-laden X Ltd. to Y Ltd., which is controlled by A.

(2) Amalgamation of X Ltd. and Y Ltd. to form XY Ltd.

(3) XY Ltd. possesses all the assets of X Ltd. subject to all the liabilities of X Ltd. and Y Ltd.; thus XY Ltd. now pays A the purchase price of the X Ltd. shares which is a capital and therefore tax-free transaction.

²⁴ 59 D.T.C. 1138; 1959 C.T.C. 284, affirming 58 D.T.C. 466; 20 T.A.B.C. 41.

²⁵ 59 D.T.C. 1217; [1959] C.T.C. 350. (An appeal to the Supreme Court of Canada is pending in this case.)

Section 105C imposes a tax of 20% on the difference between the net asset value of XY Ltd. and the total undistributed incomes on hand of X Ltd. and Y Ltd. The section does not, however, impose any tax when taxpayer A sells his X Ltd. shares to Y Ltd. in exchange for preference shares instead of a promise by the company to pay. These preference shares may be converted into preference shares of the amalgamated company on amalgamation.²⁶ After amalgamation, they may be redeemed without attracting tax.

However, in such amalgamations, despite the fact that section 105C does not impose tax, careful regard should be had for the provisions of section 81. To consider the application of section 81 to amalgamations, it is first necessary to know that, in most provinces where statutory amalgamations may be carried out, the Companies Act provides that upon amalgamation, the amalgamating companies are amalgamated "and continue as one company". The companies are not wound up, nor do they cease to exist. In a vertical amalgamation, such as the one given as the example, the shares of X Ltd. which are held by Y Ltd. must, on amalgamation, all be cancelled, otherwise the amalgamated company would hold its own shares. It also seems that Y Ltd. has received an amount for or in respect of the cancellation because all assets formerly held by X Ltd. are now held by XY Ltd., and XY Ltd. may be considered as having been formed by a welding together of X Ltd. and Y Ltd. Therefore, Y Ltd. has acquired some sort of interest in the assets of X Ltd. The

value of this interest would likely be considered as one-half of the value of the net assets of X Ltd.

If we consider this analysis in the light of section 81 (2), we may say that X Ltd., at a time when it had undistributed income on hand, reduced its common stock. Therefore, a dividend is deemed to be received by Y Ltd. equal to the lesser of the undistributed income on hand of X Ltd. or one-half of the net value of the assets of X Ltd., less liabilities of X Ltd.

This dividend, so far as it is deemed to have been paid out of designated surplus, is taxable at full corporate rates to Y Ltd.

It is clear that section 81(2) was not drafted with a view to imposing tax in statutory amalgamations. The Department of National Revenue has not yet indicated, however, whether it intends to apply this section to amalgamations which escape the tax provided by section 105C. It may confidently be expected that this area of the Income Tax Act will be amended in 1960 to provide greater certainty as to the incidence of tax in such cases.

Conclusion

The leading 1959 cases differ from those of earlier years when the court was preoccupied with "capital gain cases". Although many "capital gain cases" are still taken to the Tax Appeal Board every year, they are normally dealt with as mere questions of fact without the enunciation of broad principles of law which now appear to be settled.

Our taxation administration becomes more sophisticated every year, and the knowledgeability of the ac-

²⁶ See, *The Corporations Act, 1953, Stat. Ont., 1953, C. 19, S. 96(2)*.

counting and legal professions in the field of taxation is constantly improving.

It is probably for these reasons that we are encountering a heavy concentration of judgments involving questions of appeal procedure and more complicated problems, such as family income splitting and foreign tax credits.

The biggest tax news of 1959 was probably the general recognition that the subject of corporate re-organizations will require extensive review in 1960. Further amendments to the Income Tax Act will bring us closer to the point where, as some prophets foretold years ago, our taxation law will compare in complexity with the Internal Revenue Code.

The Disease of Overwork

In the years since the war, the health of business executives has been increasingly discussed, at first in the context of jokes about peptic ulcers, and recently in a less lighthearted framework of references to coronary thrombosis.

Any danger that general discussion of the problem may produce executive hypochondria is more than offset by the savings in efficiency that preventive medicine can effect if given a proper chance. But it is still worth remembering that executives have no monopoly of stress-complaints; doctors themselves are also sufferers and, in quite another age group, undergraduate suicides have been reported as increasing. Also, it has to be remembered that for many, perhaps most people, stress is the spice of life — and many, perhaps most, executives are extremely fit; if they were not, they could not have reached their present positions.

On the other hand, a great many of them work harder than they should. Some of them do so because they are obsessed by work, some do it to escape from other stresses (how many men stay late in the office because their domestic life is unsatisfactory?), and some because the job is too big for them and they are endlessly struggling to catch up with it; it is not easy for anyone to refuse promotion (or indeed to acknowledge inadequacy for the next job up), but there are times when it is very wise to do so. Whatever the real cause of the overwork, it needs no research to demonstrate that it is bad for the individual and in the longer term for his employer too. "He worked himself to death" is a too familiar epitaph.

—“Take It to Heart!”, *Accountancy*, December 1959

Business Charts

THOMAS J. DIGGORY

THIS ARTICLE might well be sub-titled "A Picture is Worth a Thousand Words". Charts are fundamentally pictures composed of lines or symbols which depict sets of circumstances difficult to understand from words or figures.

There are many areas of business to which charting techniques can be applied; they include analysis of financial and statistical data, analysis of clerical routines and procedures, production control and forecasting, engineering calculations of all types, market forecasting, etc. In all of them, the chart is a tool of analysis employed to facilitate understanding and promote decision-making by means of graphic presentation of information. In this article we consider the use of charting techniques for the analysis of financial and statistical data and the analysis of clerical routines and procedures, these areas of business being of particular interest to the accountant or controller.

Charting Financial and Figure Data

Presentation of quantitative data in a form readily understandable to the reader has presented problems to the accountant and statistician alike for many years. In arriving at the solution to these problems, those concerned have become involved in new

techniques collectively described as "graphic art". "Graphic art" is a comparatively modern term, and the "art" involved lies in giving eye-appeal to material or data which would otherwise be uninteresting or incomprehensible. A variety of devices have been used, all of which will be familiar to those who read financial papers and company reports. These devices range all the way from "pie" and "bar" charts to pictorial exhibits using symbols to illustrate comparisons of various types of data. Before illustrating the uses in business for the various types of graphic art, it seems appropriate to summarize the aims to be achieved in charting the facts of business.

Purpose and Value

The accountant or business statistician is well acquainted with involved financial statements and lengthy tabulations of data. These are the tools of his profession. With experience, he can rapidly assimilate such information and assess the significance of figure data at a glance. This is the language of accounting and finance, just as punched holes are the language of punched card equipment or the binary code is the language of electronic computers. They are equally unintelligible to the uninformed,

XYZ COMPANY LTD.
OPERATIONS OF PRODUCT DIVISIONS
RETURN ON EQUITY & ASSETS
YEAR TO MARCH 31, 1958

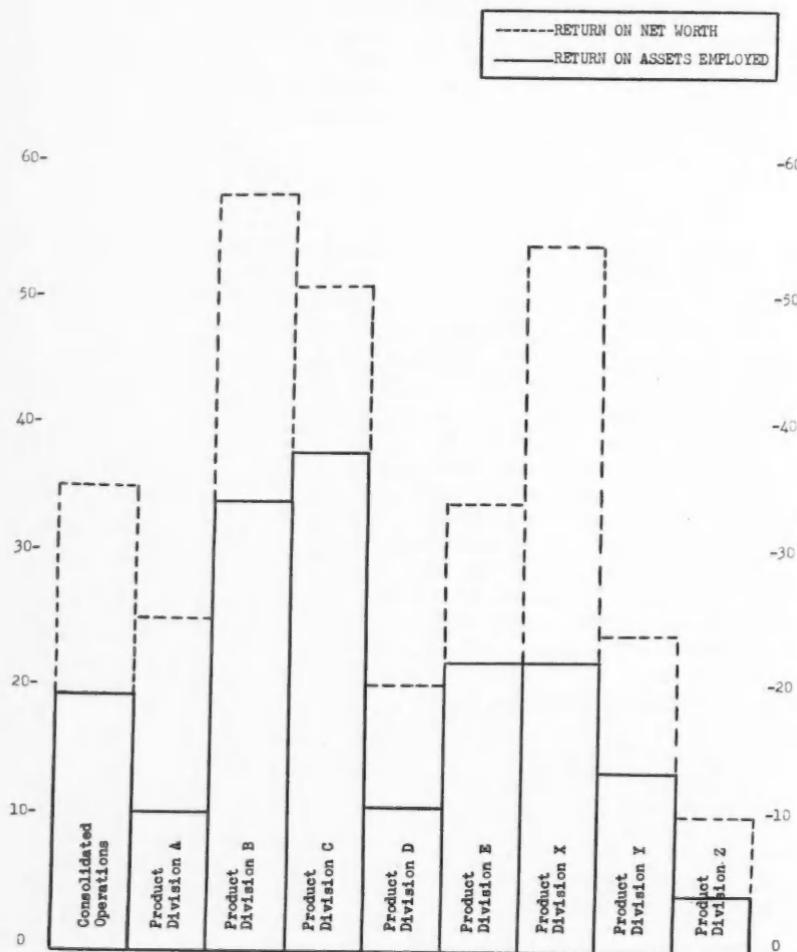


Fig. 1 - Bar Graph

and need translating into a "common language" before presentation.

It is important that accountants realize this need to convert their language into a form which will be understood by others when presenting the results of their work. The preparation of accounting statements for management is only justified if they can be readily understood and acted upon. Graphic presentation is a form of "common language" which enables management to rapidly grasp the significance of financial data.

Types of Graphic Presentation

Illustrated below are some examples of the most commonly used business charts, together with descriptions of other types of more limited application.

PIE CHARTS

Pie charts are most often used in shareholders' reports and in publicity material to depict such favourite topics as the allocation of the sales dollar to materials, wages, taxes and dividends.

BAR GRAPHS

Employed rather more frequently than pie charts, bar graphs provide useful comparisons of data, but they can only show broad inter-relationships, as illustrated in figure 1 (page 248).

LINE CHARTS (Arithmetic Scale)

Line charts are the most common medium for charting business results. They are particularly useful for facilitating the projection of future results on the basis of trends of actual results over a period.

Figure 2 (page 250) illustrates how effectively this type of graphic presentation portrays the most significant

aspects of a company's operating results.

LINE GRAPHS (Semi-Logarithmic Scale)

Line graphs are used less often than they might be because of a lack of appreciation of their significance in portraying business data. The semi-logarithmic graph, for example, may indicate that, although sales are increasing over a period, they are increasing at a decreasing rate.

PICTORIAL CHARTS

Like pie charts, pictorial charts have limited application in business. They are most frequently used in publicity material or company publications of general interest. Pictorial symbols in the form of sketches of company products, personnel or equipment can be used to illustrate broad relationships in certain key company statistics, such as changes in sales volume, staff or facilities, over some fairly lengthy time interval.

Use of Charts for Financial Control

The charts illustrated in the preceding sections have one common characteristic: they are historical. Such charts are certainly informative, but how do they contribute to business decision-making? Past results undoubtedly affect future decisions, but how can past results promote decisions?

The break-even chart is probably the best example of the "action" type of chart. Actual results can be compared against predetermined standards and action taken to correct any adverse trends. Such charts can be prepared for separate segments of a business, such as departments or cost centres, to convey to those responsible the effectiveness of their operations.

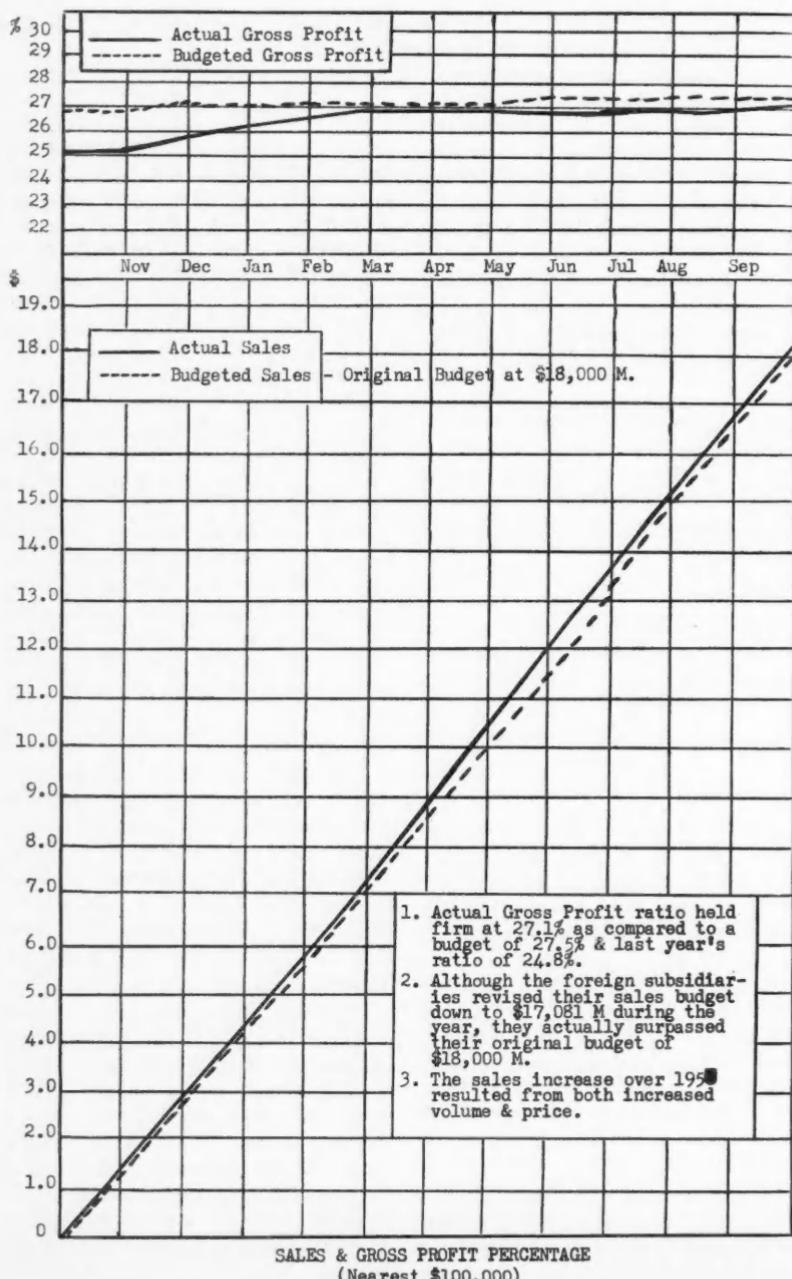


Fig. 2 - Line Chart

Reporting results by area of responsibility is the most effective way of ensuring corrective action where necessary.

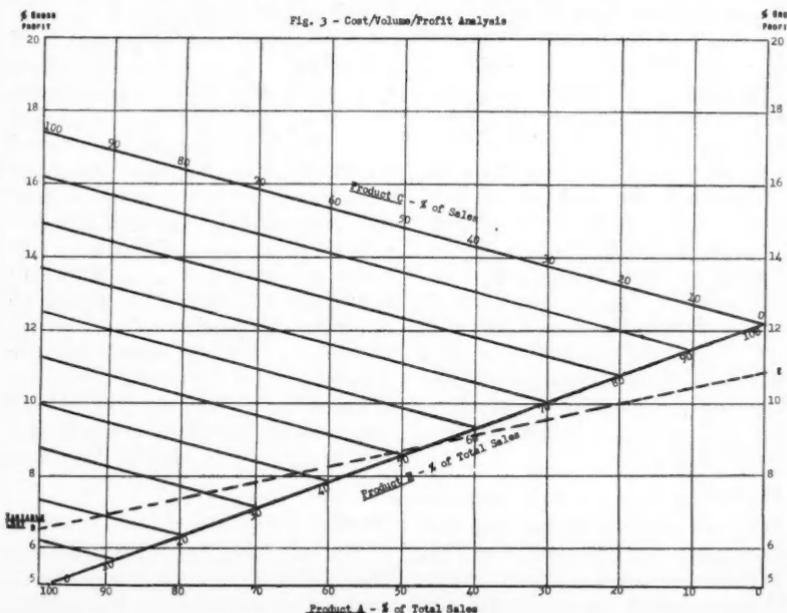
A variation of this type of chart is set out in figure 3 below in an illustration of the break-even concept complicated by a product-mix problem. Briefly, the problem is that of a company having a basic product (A) on which a gross profit of 5% only can be realized. Two other products, B and C, can each contribute gross profits of 12.2% and 17.4% respectively. Expenses vary from 6.5% of sales, when sales are predominantly of product A, to 11.0% of sales, when none of product A is sold. This latter situation is purely hypothetical, however, since product A must remain the basic product.

Company management can readily see from the chart that only mixes of products above the expense break-

even lines are acceptable. They may also decide that at least 60% of product A must be sold. Given this situation, an unlimited variety of proportions of products A, B and C can be interpolated yielding gross profits above the expense break-even line. For example, if product A is 70% of total sales, 30% will be made up of products B and C; in order to break even, no more than 22.5% of product B can be sold.

It should not be construed from the above that charts or graphs should be used indiscriminately to illustrate financial or other business data, nor should they be prepared without careful assessment of the merits of the particular form of presentation to be used. Charts can be misleading, particularly if the choice of scale is faulty.

In presenting complex figure data, however, graphs or charts can often



succeed where the best designed statement will fail. The ultimate objective in using the graphic form of presentation is to facilitate understanding. The technique should be considered as one more tool in the hands of the accountant, a tool that will help him in his function of providing for management information on the operations of the business.

Charting Routines and Procedures

The second area of business to which charting techniques can be applied is in the analysis of routines and procedures. Flow charts, as this type of charting is commonly called, are invaluable as a means of diagnosing the problem areas in business routines. The various aspects of flow-charting techniques are considered below under appropriate headings.

Purpose and Value of Flow Charts

A sample flow chart of a purchase order routine is illustrated in figure 4 (page 253). From this example, the flow of paper and sequence of operations can readily be seen and understood. Such charts, apart from assisting in the tracing and understanding of routines, can be used to test modifications or new routines and provide a valuable aid in the presentation of revisions to those immediately concerned. If a logical approach is taken to drawing a flow chart, it is usually simple to prepare, often takes less time than a written description and is more complete. Flow charts are useful reference documents in a procedure manual.

Use of Flow Charts

The flow chart is particularly useful when a routine crosses several departments or when portions of a multi-part form receive different

handling. It is invaluable as an aid in understanding routines which have many steps or variations. Conversely, routines which consist of a few single steps or involve only one person are best described by a step-by-step outline.

Basic Types of Flow Charts

BLOCK DIAGRAMS

Block diagrams were the earliest form of business chart, easy to prepare and easy to explain, but necessarily restricted to simple routines.

The "block schematic" diagram is commonly used for organization charts, office and plant layouts and other static conditions, but is not suitable for complicated routines where operations and the flow of information must be presented.

PUNCHED CARD FLOW CHARTS

Punched card flow charts were perfected by the manufacturers of punched card equipment as a means of portraying the sequence of operations performed by their equipment in processing financial and statistical data. To facilitate the drawing of charts, the manufacturers have developed templates made up of symbols of varying designs used to represent different types of machine processes. Drawing a punched card flow chart is a specialized technique requiring knowledge of equipment capabilities and processes, but the punched card template can be adapted to the flow charting of clerical routines, provided the significance of the symbols is clearly defined at the start.

PROCESS CHARTS

Process charts are most commonly used to illustrate step-by-step clerical routines. Preprinted forms describing

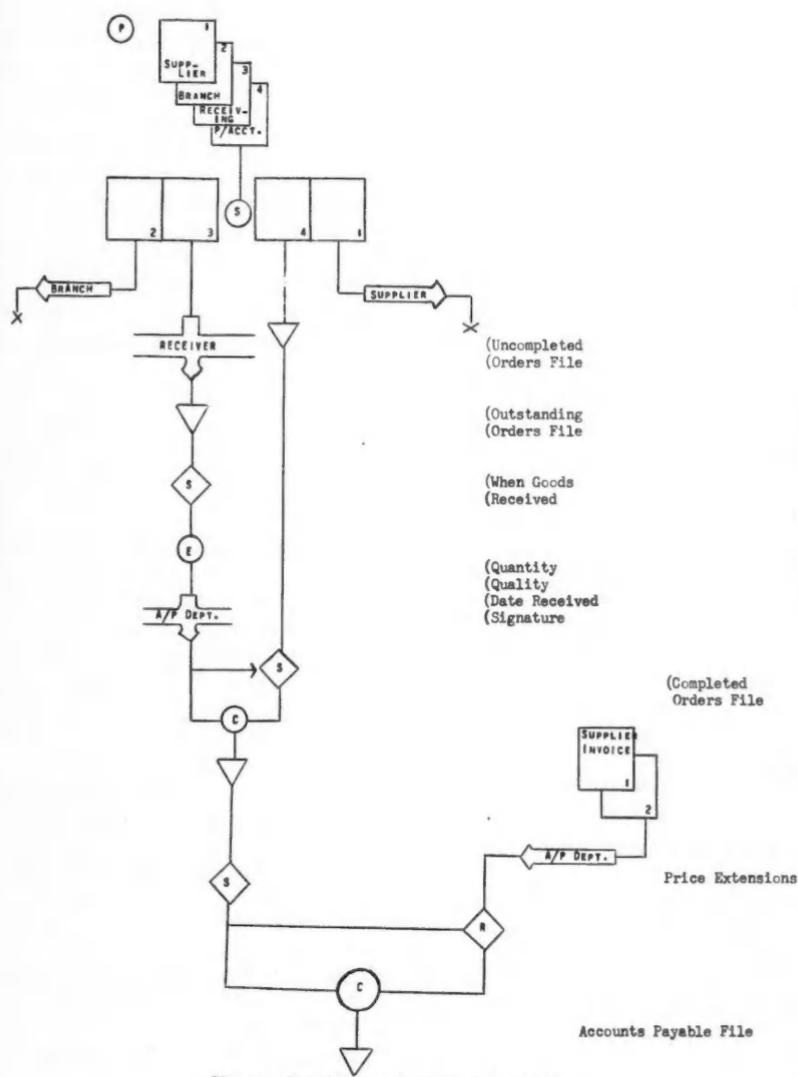


Fig. 4 - Flow Chart - Purchase Order Routine

the various processes involved in a routine are useful for preparing such charts, particularly for providing a quick summary of all the clerical steps, highlighting duplication of effort and overlapping of routines.

VERTICAL FLOW CHARTS

Vertical flow charts are popular with systems analysts as a means of following routines in considerable detail. Figure 4 is an example of the vertical flow chart. This type of chart is easy to rough out using a set of standard symbols, but it can become exceedingly complex unless procedures are subdivided into logical subroutines. The vertical flow chart is often preferred for investigation, analysis and installation work.

HORIZONTAL (DEPARTMENTAL) FLOW CHARTS

Forms suppliers frequently use the horizontal chart for display purposes. It can be quite effective in illustrating the use of multi-part forms although the completed chart can be cumbersome. There are other advantages claimed for this method similar to those for vertical flow charts. Essentially both types endeavour to portray continuous movement from one operation to another.

VISUAL SCHEMATIC CHARTS

These are effective for depicting routines in broad outline. They are, however, somewhat expensive and difficult to prepare.

Constructing a Flow Chart

After preliminary investigation to determine the need for a flow chart, time can be saved by rough-charting a routine through observation and interview. This approach has the effect of defining the area of investigation and outlining the main features

of the routine. Later, a detailed chart can be prepared by following the flow of paper through the various clerical or mechanical operations involved and discussing the details with those concerned with the various operations.

Completed flow charts should always be checked back for contradictions to ensure the establishment of a sound basis for subsequent systems modifications.

Flow Charting Technique

A set of distinctive symbols should be designed and used consistently in the preparation of flow charts. These symbols will designate either a particular activity or a type of form. Examples of different types of activity and forms are illustrated below.

ACTIVITY

Operations—Any activity that adds, subtracts, changes or creates a form, group of forms or object.

Transportation — Movement of form, group of forms or object from one physical location to another.

Inspection — Examination or verification of the data, form, group of forms or object without changing.

Delay — Delay of form, forms or object pending further activity.

Storage — Form, forms or object not involved in any of the above activities.

FORM

Form — Vehicle for conveying information from one place or time to another place or time.

Record — Form on which the data is finally recorded.

Miscellaneous—Adding machine tape; Cheque or small form.

The form used for flow charting should allow for five vertical columns

spaced across the form to ensure the inclusion of all necessary information. The five columns should be headed as follows:

1. Function

The functions charted. Individual functions should be identified in a word or two on the same horizontal line that the first symbol appears. This is, in effect, a summary of the functions charted as well as a guide in reading the chart.

2. Activity Area

The next column is used to record the person or location pertaining to the activities charted.

3. Reference Records

Column used to show and explain reference material and records involved in the procedure. Column is also used to record type of machines used, volumes processed, timing information, etc.

4. Chart

The next section is usually many times wider than the previously mentioned columns. This section is the chart itself and is divided into departmental units.

5. Particulars

This is the detail column and is situated to the right of the chart. All details of the activities are recorded in this column.

At the beginning of this article charts were referred to as "a tool of analysis". As emphasized above, this tool can be used advantageously but not indiscriminately. The flow chart is essentially a means of translating routines and procedures into graphic form for interpretation and analysis; it does not, in itself, create a procedure. Procedures must be written and instructions given in order to fulfil the purpose for which the flow chart is drawn. It is a tool of analysis by the use of which business systems can be installed or modified.

The Profession and the Unforeseen

The sort of demands that impose themselves on the solicitor or the accountant, the things for which education, as I understand the term, is really appropriate, are not automatic. Education should develop the capacity to deal, not in a predetermined way with predicted questions, but rightly and persuasively with the unforeseen. I say "unforeseen" because in law, and, I suggest, also in accountancy, you never quite get a repetition of any particular case. Very frequently it looks as if it is the same, but in point of fact it always has some very little something which the other did not have, and it is the capacity to recognize that small but possibly critical difference that makes or mars the advice which one gives to a client or a customer. Therefore the capacity to identify the unforeseen is one of the objects of true education. I used the word "persuasively" because I think that advice, however good, is only valuable if it is possible to convince the client that it is good, more especially if the advice itself is unwelcome, as from time to time it must be.

—“Education for the Professions”, Sir Arthur Fforde,
The Accountant, November 28, 1959.

Accounting in the Paint Industry

ARTHUR W. WALKER, C.A.

THE IMPORTANT role of the paint industry is amply evidenced by our surroundings. Whether in the home, office or factory, or even driving on the open highway, we are aware of the presence and value of an infinite variety of finishes.

It is not surprising that competition is keen within an industry having such a universal application. Every individual or business is a potential customer. Total paint sales in Canada in 1958 established a record of \$134 million against \$127 million in 1957. Rivalry for the sales dollar has resulted in some reduction of profit margin and has encouraged technological advances aimed at improved quality and convenience.

The paint industry manufactures and sells three basic commodities — paints, varnishes, and lacquers — together with related products such as shellac, thinners, stains, paint removers and others. These products are manufactured to a wide number of specifications based on laboratory formulas developed for the intended application.

The industry has recently seen the development of tinting systems capable of delivering an unlimited number of shades to standard base paints substantially reducing stock inventory requirements. Jelled paints are now available in semi-solid form which require no mixing and eliminate much of the disorder associated with decorating. The past year saw the introduction of a new acrylic enamel for automotive finishes which is said to retain high gloss without polishing for at least three years. Developments in polyvinyl acetate paints are anticipated which will overcome the problems of peeling and blistering that have prevented the use of water-thinned paints on many exterior surfaces.

Such constant and rapid advances in product and procedures require careful and accurate accounting methods to determine selling prices and control factory production and operating expenses. Conventional systems may be followed in accounting for cash, receivables and payables as the problems in these areas are not materially different from those encountered in the average industrial manufacturing enterprise. Sales analysis and cost accounting assume particular importance.

Sales Analysis

Sales may be classified into two distinct areas of activity: the supplying of industrial accounts and trade accounts. Industrial finishes are usually supplied directly from the producer to the industrial consumer. Such sales are generally to large and strong accounts which purchase a substantial volume of a limited number of products. This situation is quite different from that encountered in the field of trade sales. Distribution for

household consumption may be through hardware or similar dealers, and some of the larger manufacturers operate their own retail stores. Trade sales require that a large amount of capital be invested in a wide range of products and involve greater selling expense. Salesmen must obtain their orders from many small dealers and decorators whose limited assets require that extended credit be granted. A high proportion of the substantial expenditures of the industry on advertising is directed to the development of trade sales. That these two areas of activity differ is emphasized by a recent report stating that industry-wide price increases averaging 2.6% - 3% had been established in respect of trade sales, although there had been no significant changes in prices in the highly competitive industrial field. Statistics of the entire industry classify sales in these two categories and record that trade sales in 1958 accounted for slightly over 60% of total volume. The value to management of an accounting separation of these two classes of sales and related expenses is readily apparent.

Further analysis of these sales categories into components may vary according to circumstances. Large businesses using tabulating equipment may wish to divide sales by class of products, product subdivisions, or class of customers. Small businesses handling limited types of product may require a much smaller breakdown. Where possible, it is advisable to segregate classes of products into the broad ranges such as paints, varnish, lacquer, etc.

Some manufacturers, particularly those operating their own retail stores, act as jobbers of goods purchased for resale such as brushes, scrapers, wallpapers, spraying equip-

ment and kindred products. A complete segregation from manufactured goods of sales, cost of sales and gross profit on resale lines is recommended.

Cost Accounting

Production operations are relatively simple and do not require the high investment in expensive machinery of many other industrial manufacturers. A brief description of the basic operations involved in the production of paint, lacquer and varnish may be of interest. Dry pigments are combined on the basis of formulas with oil, alkyd, or varnish to form a paste which is ground through pebble or roller mills and pumped to tanks where further liquid vehicle and tinting colours are added to form a batch. The manufacture of varnish differs in that it initially involves the cooking of natural or synthetic resins. Following approval by the laboratory as to batch specifications, the material is passed to the filling department. Five-gallon cans and large steel drums are usually filled by manual operation and smaller containers down to quarter pints are handled on automatic filling machines from which they move by conveyors to labelling machines. Cans are then placed in cartons and transferred to a storage or shipping area.

In costing of production, overall average costs cannot be safely used because of variations in the manufacturing costs of individual commodities in the broad product range. Reliance on average costs in this competitive industry could result in the volume sale of items whose actual cost was greater than average and failure to secure orders for those involving expenditure below average. The objectives of the cost system

must therefore be the development of departmental expenses for control purposes and the accumulation of all elements of cost for record against individual batches.

A summary of manufacturing operations broken down into departmental activities might briefly be as follows:

1. Paints and lacquers
Mixing
Grinding
Thinning and tinting
2. Varnishes
Cooking
Thinning, filtering and blending
Storage
3. Filling and packaging
4. Storage and shipping.

Manufactured alkyds are being used increasingly to replace natural oils and resins. An alkyd is formed by the chemical reaction of acids and alcohols to form a synthetic gum or resin. Where producers manufacture their own alkyds, a separate department would be established. Similarly a separate department might be set up to cover laboratory operations. The laboratory usually fills the dual function of product quality control and research development. In some cases, the latter function may be classified as a selling expense rather than a charge against production operations.

The cost of finished product contains the elements of raw material, direct labour, factory overhead and packaging. Costs may be considered to develop progressively in the following order:

1. Material cost (raw material only)
2. Bulk cost (material, labour and other costs of product in bulk form)

3. Factory-filled cost (bulk cost plus costs of containers, filling and labelling).

The need for a bulk cost separate from a factory-filled cost is apparent when it is considered that all units contained in a batch have equal cost to the point of filling. At this stage, a wide variance in costs of different-sized containers and labour involved in filling becomes a factor. The cost per gallon of five gallons filled into one container varies significantly from the per gallon cost of five gallons placed into 40 small containers.

Costing of Materials

Costing of materials commences with the receipt of raw stock into the plant. Charges are made to raw material inventory cards and controls on the basis of receiving reports and suppliers' invoices. Perpetual inventory cards may record quantities and laid down costs per material unit, or dollar value may be continuously accumulated. In some cases, first-in, first-out costing, and in others accumulated averages, may be applied. The volatile and fluid nature of many of the raw materials results in invisible losses in storage through evaporation and seepage. The extent may vary depending on type of containers and surface areas exposed. Experience should indicate the extent of such losses, and a factor may be added to unit cost to cover shrinkage for purposes of costing from raw material storage.

The cost of certain raw materials, such as linseed oil, china wood oil and soybean oil, is subject to considerable fluctuation from day to day depending on open market conditions. Costing may be simplified if inventories in this category are charged on the basis

of standards which may be revised at monthly or quarterly intervals. The purchasing department may be made accountable for significant variations from these standards.

Materials move into production from raw storage areas under the control of batch tickets. By reference to predetermined formulas, laboratory personnel insert on these tickets the pounds or gallons of material necessary to produce the required gallonage of a given line of paint. The quantities inserted must make allowance for the considerable amount of material lost in the process of manufacture through spilling, evaporation, straining, etc. The extent of these losses may differ with the overall batch gallonage, and allowances may be related to the quantity of the run.

Batch tickets serve production personnel as requisitions for withdrawal from stores of materials to be used by them. Following completion of the batch in bulk form and indication of laboratory approval of its contents, the batch tickets are forwarded to the cost department. By reference to the raw material inventory cards, the tickets are priced and extended. The accumulated value of these tickets for the accounting period is applied in reduction of the raw material inventory control account in the general ledger and is charged to work-in-process or directly to finished goods inventory accounts as established by the specific manufacturer. The direct charge to finished inventory may be used, as the production flow from batch to finished product is usually continuous covering a short period of time, thus eliminating the necessity for an intermediate charge to work-in-process accounts where value of batches in progress is insignificant. Batch tickets are also used as the

medium for reduction of quantities of raw material appearing on the raw material inventory cards.

Labour Costs

Labour costs are divided into direct and indirect components in a manner similar to most manufacturing organizations. Non-productive labour may be analyzed into detailed general ledger accounts showing costs of supervision, material handling, janitorial services, maintenance, idle time and many others. Productive labour is reported on employees' daily time reports wherein each employee indicates the hours spent on various operations, such as mixing or grinding, the formula number of the product being made and the number of the batch. These time reports are extended and used by the cost department in accumulating batch costs and in departmental labour distribution. Accumulated batch costs may be compared with records of previous experience for the same formula as an element of control. Where standard labour costs are used, the accumulated actual costs in various departments may be compared with the standards, and responsibility for variances may be assigned to the specific departments.

Overhead Expenses

Factory overhead may be accumulated for all products on an overall average cost per unit basis. However, this may be unsatisfactory where a wide variety of high and low-cost items are produced or processing time in different departments varies among products. In such cases, it would be wise to maintain separate factory overhead accounts for each depart-

ment. An overhead rate is then developed by dividing the aggregate overhead of the department by total productive labour in the department, and application of overhead is accomplished through multiplying productive labour by this rate.

Some formulas call for quantities of varnish, alkyd or other components which may be manufactured by other departments in the same plant. In such cases, costs of the manufactured components are developed in a manner similar to that described above, and the aggregate cost per unit is recorded as material cost to the final production operation.

From the foregoing accumulations of material, productive labour and related factory overhead expenses, bulk cost may be computed. Individual formula cost record cards are maintained by the cost department and show dates and costs of previous batches produced under a given formula. Material costs are entered from batch tickets, labour costs from employee time reports and overhead are applied. All factors are totalled to show bulk cost. This formula record may include the cost of each batch, selected batches at intervals, or the accumulated cost of a series of batches. The information on these cards may be of considerable value in management reporting and control, and is used in the preparation of quotations and setting of selling prices. Complete information cannot be obtained without the application of filling and packaging costs.

Filling and Packaging

Filling is completed on the basis of stock room requirements for various-sized containers. A filling memorandum is prepared in the department

showing the number of gallons filled and can sizes transferred to storage area. Comparison of the total gallonage appearing on the filling memorandum with materials issued and anticipated yield, as shown by batch tickets, permits the computation of actual yield per batch. Significant variations from predetermined standards or previous experience may be investigated to determine responsibility.

Filling department reports may also be used as a basis for entering perpetual inventory records of finished goods in warehouse.

Data from filling memoranda is priced from the raw material inventory cards as to the value of cans, cartons and labels used, and the total is applied in reduction of the raw stock inventory control account. Distribution of packaging labour costs to individual products would not be a problem if all batches were placed in containers of equal size. However, this is seldom the case. It will be readily recognized that variables are encountered in the handling costs of different-sized containers. Distribution of these costs can best be accomplished on a standard base. Development of the standard involves a study of the handling cost of containers of each size from drums down to the smallest unit, and weighted unit factors may then be established for each. Unit cost is then represented by total handling cost divided by the total number of units handled in the accounting period. The cost of handling each size of package is determined by multiplying unit cost by the standard unit factor applicable to the particular container. With this information, records may be established combining bulk cost per unit with filling and packaging costs per unit

to show factory-filled cost. In arriving at selling prices, distribution, sales and administrative expenses must be added to factory-filled cost.

Miscellaneous Problems

A problem in the industry arises from the necessity of producing both large and small batches to meet customer requirements. Small batches result in increased manufacturing expense, and the cost per gallon may be substantially higher than that of full-batch quantities. Accurate costing of fractional batches and a policy in respect of their selling price are therefore necessary. Some difficulties may be overcome by the operation of a separate small-batch department with special equipment for that purpose.

Producers maintaining sufficient cost accounting personnel may determine cost of sales by the individual costing of each sales invoice or by periodic extension and accumulation of perpetual inventory records. Other manufacturers not maintaining these records must determine cost of sales on the basis of physical inventory counts and valuations at desired intervals. Interim financial statements may be prepared using percentages to determine gross profits on the basis of past experience.

Analysis of selling and administrative expenses may be extensive or limited to meet requirements under prevailing circumstances. Manufacturers distributing through a combination of their own and independent dealer outlets must constantly be alert to the relative economy and profit returns of the two methods. Segregation of sales and expenses in these two areas may be of significant value.

The introduction of new products

and overruns of special lines lead to a problem of obsolescence in inventories. Careful analysis of inventory is important for effective utilization of production and to limit capital investment to the greatest extent. A fixed policy of obsolescence write-off on the basis of movement is necessary to accurate reporting of results.

Supervision of credits is another important area of responsibility. Many dealers and decorators operate on a limited capital investment and rely on suppliers for financing of their businesses. High-credit risk is involved with such customers, and careful control is necessary if losses are to be avoided.

Financial Reports

The paint industry is similar to all others in that financial information must be promptly presented to management in order for the outlays on costing and accounting to be of value. Some of the reports which might be prepared monthly are as follows:

1. Balance sheet
2. Operating statement
3. Classified sales report (showing sales and gross profit by class of product sold to trade and industrial accounts and by company stores and other outlets).
4. Sales expense report (showing expenses of salesmen and company stores by territories).
5. Factory production report (showing kind and quantity of each item produced for the month along with actual costs and standards or average previous cost).
6. Factory departmental operating report (showing departmental production and operating costs and average cost per unit handled in each department).

7. Accounts receivable report (showing customers' balances aged as to term outstanding and indicating status of past due accounts).
8. Inventory report (showing quantities of items on hand that have not moved significantly in a specified period).

These reports might be supplemented by others, as required, to assist officials in the supervision of their responsibilities.

To be of fullest service, the accounting system must be fitted as pre-

cisely as possible to the individual manufacturing operation and should be neither more simple nor more complex than the enterprise itself. It should never omit any essential factor of financial protection or managerial control.

The successful manufacturer must be in a position to maintain or improve his position within the industry. Adequate financial information supplied to management in clear and concise form may be the most important element in accomplishing this objective.

Men at the Top

Standard specifications for top men in expanding organizations normally include a capacity for hard work, determination, flair, ability to inspire enthusiasm, willingness to take risks, readiness to grasp opportunities and luck. The list does not necessarily include outstanding powers of leadership, and it is often astonishing how far men have got without them. The answer normally is that they have enough in hand in terms of the other qualities to more than compensate for any weaknesses as leaders.

To this formidable list must be added a quality which is frequently overlooked — the ability to make quite large mental and emotional adjustments as their organizations expand, and to realize when the point has been reached at which they must adapt their thinking and behaviour to the new possibilities which they created. For if they develop their organizations beyond a certain size, they will have to restrict their activities to such matters as long-term planning, capital expenditure, the selection and training of key personnel, the broad appraisal of current results and various ceremonial and ritual appearances or functions.

—B. A. Maynard, "Expansion — Some Organizational and Financial Factors", *Accountancy*, December, 1959

Financial Statements for Farmers

ALAN W. BELL, C.A.

BUSINESS CONCERNS generally prepare financial statements and file income tax returns on an accrual basis. However, farmers, fishermen and professional men are permitted to report their incomes for tax purposes on a cash receipts and disbursements basis. In Western Canada, farming and ranching is big business, and quite frequently grain and/or cattle inventories amount to from \$100,000 to \$400,000. Although most of these farmers report for tax purposes on a "cash basis", financial statements are very often prepared on an "accrual basis" for credit and other management purposes. In the preparation of these accrual statements, a serious accounting problem occurs with the calculation and presentation of the liability for income tax.

During the past few years, a number of articles have been written dealing with the inter-period allocation of income taxes, and interested readers may refer particularly to discussions by Moonitz and Hill which appeared in the April and July 1957 issues of *The Accounting Review*.¹

In exhibit 1 (page 266) are set out condensed statements of cash income and expense for a large incorporated farm for its first five years of operations. The income tax figure shown

is the actual tax payable, assuming the company filed on a cash basis.

Exhibit 2 shows the net cash income before income tax adjusted to give effect to grain inventories on hand at the end of each year. For simplicity it has been assumed that all farm work was done by contract and that all liabilities other than income tax were paid before the end of each year.

The calculation of the amounts shown as provision for income tax in exhibit 2 and the presentation of the corresponding figures in the company's balance sheet will be discussed in this article.

One possible solution is to show a provision for income tax only when tax is actually payable. If this plan is adopted, the year 1955 is charged with \$27,500, the year 1957 with \$1,900, and no charge is made against the profits of the other years. This produces results which are illogical and incorrect in the following ways:

¹ Maurice Moonitz, "Income Taxes in Financial Statements", *The Accounting Review*, April, 1957, pp. 175-183 and Thomas M. Hill, "Some Arguments against the Inter-Period Allocation of Income Taxes", *The Accounting Review*, July 1957, pp. 357-361.

1. It disregards the general principle that costs should follow related revenues.
2. It gives the lay reader an entirely incorrect picture of the net profit which may be expected to eventually flow to the shareholders.
3. It results in an overstatement of the current working capital position.

It may be argued that the above criticisms are best overcome by a note in the auditor's report explaining the basis on which income is reported to the Taxation Division, leaving the reader to make any adjustments he may consider necessary. It is the opinion of this writer, however, that the accountant does not discharge his full duty to his client or to the public when comments in his report suggest that the reader make adjustments to the financial statements which the accountant should be able to make much more intelligently himself. In addition, one might consider such a statement in the report a qualification, and a qualification of such import as to negative any opinion otherwise expressed.

Below is an outline of a method of dealing with the problem which meets the above objections. In arriving at this solution, the guides have been the statements in chapter 10 of Accounting Research Bulletin No. 43 issued by the American Institute of Certified Public Accountants, the principles discussed in Research Bulletin No. 10 issued by the Canadian Institute of Chartered Accountants,

and the discussions in the articles referred to above.²

The following assumptions have also been made:

1. The provision for income tax should be the best possible estimate of the amount of tax that will eventually be payable on the income reported.
2. Any estimate of the amount of tax that will be payable must be based on the concept of a going concern and accordingly must give recognition to the averaging provisions of section 42 of the Income Tax Act.³

Taking each year individually, the amount of the provision for income tax may be calculated as follows:

1953 — 20% of \$10,000 or \$2,000.

1954 — 20% of \$30,000 or \$6,000. The reason the low rate of tax is used on the total income of \$30,000 is that on the premises laid down it is known that the total tax for 1953 and 1954 cannot exceed \$8,000. This is true under *any* assumed income for the remaining three years of the averaging period.

1955 — 20% of \$20,000 plus 47% of \$10,000 or \$8,700. It is a fact, however, that the amount of the tax liability at the end of 1955 is \$27,500, and there can be no justification for showing any lesser amount as a current liability. It is obvious, therefore, that to show a liability of \$27,500 and at the same time accrue only a total of \$16,700 by charges to profit and loss, a

² Ibid.

³ It is true that, under the wording of the section, it is only the tax in the year of averaging that is affected, but consider-

ing the assumption of a going concern, it is more realistic to read the section as though it called for revised returns to be filed for the four years prior to the averaging year.

debit of \$10,800 is left to be dealt with in the balance sheet. What is the nature of this debit? At a minimum, it is a deferred charge to future operations, and under some conditions it could end up as an account receivable from the Taxation Division. Certainly, it is a fact that the tax on the total income to the end of 1955 could not exceed \$16,700 regardless of what assumptions we might make as to the income for the following two years. Accordingly, it would be incorrect to charge profit and loss with a greater amount.

1956 — 20% of \$20,000 plus 47% of \$10,000, or \$8,700.

1957 — 20% of \$20,000 plus 47% of \$10,000, or \$8,700.

It might be argued that it is misleading to show a tax of \$6,000 in 1954 and \$8,700 in 1955 when the income and tax rates in both years were the same, and that \$1,350 of the 1955 tax should be shown separately as an adjustment of the 1954 tax. In preference to the above treatment, because it results in each year being charged tax at the going rates on the income reported, the writer suggests taking into account previous income in the averaging period but without making any assumptions as to what the income may be in any remaining years in the averaging period.

If the five year totals are examined, it is found that the income tax accrued is \$4,700 more than the amounts required to be paid under the tax law, this being tax at the 47% rate on the \$10,000 inventory at the end of 1957.

It follows, however, that the treatment suggested for the profit and loss statement can be supported only if the corresponding figures can be shown in the related balance sheets in

a logical and meaningful manner. In exhibit 3 is set out the manner in which these figures might be shown in the balance sheets for the five years. Attached to each balance sheet there should be a complete description of the basis on which the company is filing its tax returns and a concise statement of the effect this has on the accounts.

In Bulletin No. 10, issued by the Committee on Accounting and Auditing Research of the Canadian Institute of Chartered Accountants, the committee dealt with the cases where depreciation recorded in the books of account differed substantially from the amount claimed for income tax purposes. The committee suggested that any material reduction in current taxes resulting from claiming depreciation for tax purposes in excess of recorded depreciation be treated as a deferred credit applicable to future years. In the present case, there is a very similar situation in the years 1953, 1954, 1956 and 1957 where, in effect, inventories have been written off for tax purposes, but are retained on the books for financial statement purposes.

The treatment shown in exhibit 3 is preferable to the deferred credit method of presentation because it relates the future tax liability to the inventory by means of a tax penalty account which is shown as a deduction from the inventory on the balance sheet. The reason for preferring this treatment can be expressed most adequately by quoting from an article in *The Accounting Review*, April 1958, in which E. S. Hendrickson makes the following statement on page 219:

"An asset which will be subject to a tax penalty when it is used or realized into cash is certainly not worth its face value; this decrease in its

Exhibit 1
STATEMENT OF CASH INCOME AND EXPENSE

	Sales	Expenses	Net before tax	Income tax	Net
1953	\$ 30,000	\$ 60,000	\$ (30,000)	\$ —	\$ (30,000)
1954	70,000	70,000	—	—	—
1955	170,000	70,000	100,000	27,500	42,500
1956	70,000	70,000	—	—	—
1957	120,000	70,000	50,000	1,900	48,100
	<u>460,000</u>	<u>340,000</u>	<u>120,000</u>	<u>29,400</u>	<u>90,600</u>

Note: 1955 tax is 20% of \$20,000 plus 47% of \$50,000.

1957 tax is 20% of \$100,000 plus 47% of \$20,000, less \$27,500 paid in 1955.

Exhibit 2
STATEMENT OF PROFIT AND LOSS

	Net cash income	Opening inventory	Closing inventory	Profit before tax	Income tax	Net profit
1953	\$(30,000)	\$ —	\$40,000	\$10,000	\$2,000	\$ 8,000
1954	—	40,000	70,000	30,000	6,000	24,000
1955	100,000	70,000	—	30,000	8,700	21,300
1956	—	—	30,000	30,000	8,700	21,300
1957	50,000	30,000	10,000	30,000	8,700	21,300

Exhibit 3
SUGGESTED BALANCE SHEET PRESENTATION

	1953	1954	1956	1957
CURRENT ASSETS:				
Grain inventory	\$40,000	\$70,000	\$30,000	\$10,000
<i>Less</i> Estimated provision for income tax eligible on sale	2,000	8,000	—	4,700
	<u>38,000</u>	<u>62,000</u>	<u>30,000</u>	<u>5,300</u>
DEFERRED CHARGE:		1955	1956	1957
Estimated amount of accrued income tax applicable to future years		10,800	2,100	—
	<u>10,800</u>	<u>2,100</u>	<u>—</u>	<u>—</u>
CURRENT LIABILITIES:				
Income tax payable		27,500	—	1,900
	<u>27,500</u>	<u>—</u>	<u>1,900</u>	<u>—</u>

valuation should be reflected in the statements preferably as a deduction from the face value. The present value of all streams of service to be derived from an asset should be offset by the present value of future payments necessary for the realization of the service value. The rule against offsetting assets and liabilities is not violated here because the obligation to make future payment is contingent upon the conversion of the asset and the asset valuation is not independent of the future tax payment."

On this basis, the journal entry required to record the provision for income tax in 1953 and 1954, taken together, would be:

Profit and loss (income tax) \$8,000	
Inventory tax penalty	
account	\$8,000

The accounting problem in 1955 is of a different nature. There is no question but that the actual amount of tax payable of \$27,500 must be shown as a current liability. A total of \$8,000 has already been accrued in 1953 and 1954, and therefore the required journal entry in the accounts is as follows:

Inventory tax penalty	
account	\$ 8,000
Profit and loss (income tax)	8,700
Deferred charges	10,800
Provision for income tax	
liability	\$27,500

An analysis of the nature of the figure of \$10,800 shows that it results from tax being payable at the 47% rate on \$50,000, but profit and loss being charged with the 47% rate on only \$10,000. This \$10,800 will either be received back as a refund from the Department of National Revenue or will be a proper charge to the profits of future years.

Following the analysis to the year 1956, it will be found that the total tax accrued at normal rates amounts to \$25,400 compared with actual tax paid of \$27,500, leaving a debit of \$2,100 to be carried forward to 1957. The journal entry recording the 1956 tax would be:

Profit and loss (income tax) \$8,700	
Deferred charges	\$8,700

The reason the \$30,000 inventory at the end of 1956 is shown at face value is that it will not be subjected to any tax penalty when it is realized into cash. The accrual income for the four years is \$100,000 which will attract a maximum tax of 20% on \$80,000 plus 47% on \$20,000 or \$25,400, as against \$27,500 actually paid to date.

Turning now to the year 1957, we have shown as a current liability the \$1,900 tax actually payable and have reduced the carrying value of the \$10,000 grain inventory by \$4,700, the journal entry being:

Profit and loss (income tax) \$8,700	
Deferred charges	\$2,100
Provision for income tax	
liability	1,900
Inventory tax penalty	
account	4,700

One might argue that an intelligent business man would so arrange his affairs that he would never pay more than the 20% rate of tax on the eventual wind-up and sale of the grain inventory and that we would be justified in accruing tax on that basis in the final year of an averaging period. As a practical matter, in dealing with a client, this may be justified in some circumstances providing the notes to the statements are sufficiently explanatory. If we adopt this stand, the provision for income tax in 1957 would be shown as \$6,000, and the inventory valuation account would show a credit of \$2,000. In no fu-

ture year would the latter account be more than 20% of the grain inventory.

Although the discussion so far has been centred around the allocation of income tax as between fiscal periods, there is one further question of procedure which should perhaps be mentioned in any discussion of financial statements of "cash basis" taxpayers. For some years the writer has always prepared two separate sets of statements for large farmer clients. One set was prepared for the Department on a "cash basis", and these statements have been clearly marked in the following way:

A. B. C. FARMS LTD.

Balance Sheet

As of December 31st, 1956

(Prepared on a "cash basis" of accounting)

The accompanying audit report has mentioned that the grain or cattle inventories and liabilities for current operating expenses have not been reflected in the statements and that accordingly the statements did not pre-

sent fairly the financial position at the balance sheet date nor the operating results for the fiscal period then ended. The second set of statements in which inventories and liabilities were properly shown were headed up in the normal manner, and, where applicable, were accompanied by a standard auditor's report.

Upon reflection, it seemed preferable to prepare one set of statements in which inventories and liabilities are properly recorded, and to give the Department a schedule reconciling the reported income with the "cash income" shown on the tax return.

Although this discussion has dealt with an incorporated farm, the principles are applicable to the preparation of accrual statements for any "cash basis" taxpayer. Where the taxpayer is not incorporated, the problem becomes even more complex.

This is a challenging and important problem that affects a great many practitioners, particularly in Western Canada.

Second Best

We read that accountants form the second best dressed section of the British male population. This gratifying news was announced last October by the Wholesale Clothing Manufacturers' Federation as the result of the 1959 poll of its 400 members. The best dressed men of 1959 are politicians, and the next best dressed after accountants are bankers. Then follow in descending order doctors and dentists, actors, lawyers, master-builders, architects, journalists, hoteliers and publicans, shopkeepers and, last of all, civil servants.

-The Accountants' Magazine, December 1959.

Recommendations on the Income Tax Act

Joint Recommendations on the Income Tax Act submitted by the Canadian Bar Association and the Canadian Institute of Chartered Accountants.

Toronto, January 27, 1960.

To The Honourable Minister of Finance, and
The Honourable Minister of National Revenue.

Dear Sirs:

We submit herewith the annual brief of the Joint Committee representing the Canadian Bar Association and the Canadian Institute of Chartered Accountants for the year 1960.

In submitting the brief to you in 1959, we drew to your specific attention six matters which we felt were particularly important in the work of our professions and to the taxpayers generally. Four of those six are represented in this brief after another year of experience and consideration.

Our recommendations respecting business expenses, reserves and advance tax rulings are much the same. However, to solve the designated surplus problem we have suggested going to the root of the matter — our double taxation scheme. We recommend that a Royal Commission or Special Committee be appointed to study the problem with the object of developing a new approach for your consideration.

We have given much thought to the problems inherent in the personal corporation provisions and these have been set out in the brief with, we trust, useful solutions.

We have also considered the repeal of the foreign business corporation provision and have made our recommendation for restoration with safeguards.

Finally, we remind you again that the Income Tax Act touches the vast majority of Canadians whether as individuals or through participation in business. The effort to reduce inequities and needless irritants must be constantly pursued.

Respectfully submitted this 27th day of January, 1960.

JOHN P. KINGHORN, F.C.A.,
Chairman, Taxation Committee,
The Canadian Institute of Chartered
Accountants.

R. BREDIN STAPELLS, M.A.
Chairman, Taxation Section,
The Canadian Bar Association.

RECOMMENDATIONS FOR AMENDMENTS TO THE INCOME TAX ACT

PAYMENTS BASED ON PRODUCTION OR USE

Section 6(1)(j)

Capital payments received on the sale of property should be excluded from the operation of this section in any case where the purchase price is definite and payable within a fixed reasonable time notwithstanding that such payments are related to use or production. It would appear that the section is being administered in this way, and so there seems to be no good reason why the law should not be brought into conformity with the practice.

Recommendation: It is recommended that section 6(1)(j) be amended so as not to apply to capital payments received on the sale of property in any case where the purchase price is definite and payable within a fixed reasonable time.

LOANS TO SHAREHOLDERS

Sections 8(2) and 11(1)(da)

The change made in 1958 affecting the treatment of loans deemed to be dividends in the hands of the shareholders gave no relief to corporate shareholders on repayment of the loan in cases where the deemed dividend was taxable to the recipient. This treatment differs from that given to other taxpayers.

The new provision has not corrected the inequity that exists in connection with the determination of undistributed income of a corporate shareholder that has been deemed to have received a dividend by virtue of section 8(2). Under such circumstances the undistributed income of the receiving company is increased by the

deemed dividend even if the loan is subsequently repaid. The undistributed income of the company from which the dividend is deemed to have been received is not, however, reduced by a corresponding amount, possibly because allowance of such a deduction might lead to abuse through surplus being taxed in the hands of particular shareholders subject to a low rate of tax.

Recommendation: It is recommended:

(1) that on repayment of part or all of such a loan a corporate shareholder be entitled to deduct the amount of the repayment in computing its undistributed income, and

(2) that section 11(1)(da) be amended to permit the deduction from income of such part of any loan repaid by a corporate shareholder in the year as was, by the operation of section 8(2), required to be included in computing income of the taxpayer for a previous year,

OR

(3) that on repayment of part or all of a loan that has been deemed received as a dividend the corporate shareholder be entitled to recover the amount by which its tax (whether under Part I or Part III) had been increased by virtue of section 8(2) in a prior year in respect of the part of the loan repaid — possibly with some limitation on the time for repayment.

BUSINESS EXPENSES

Section 11(1)(a)

In order to be allowable for tax purposes, a business expense must pass two tests successfully:

(1) it must be incurred for the purpose of gaining or producing income under section 12(1)(a), and

(2) it must not be incurred on account of capital under section 12(1)(b).

It frequently happens that business expenses would be allowed under section 12(1)(a) but fail to be disallowed under section 12(1)(b). Where such expenses are eligible to capital cost allowances, deductibility is merely a matter of timing. However, where such expenses are not so eligible, deductibility is lost forever.

It appears inequitable for the taxpayer to get no deduction whatsoever in the case of expenses that have been established under section 12(1)(a), to have been incurred for the purpose of gaining or producing income. The following are examples of such disallowed expenses:

(a) An expenditure in respect of which deduction of capital cost allowance is not being permitted, although the property is not of a class expressly excluded by section 1102 of the Regulations. An expenditure of that nature was the subject matter in the case of *Saskatoon Community Broadcasting Co. Ltd. v. M.N.R.* (Tax Appeal Board, 1958).

(b) Operators of Hydro-Electric plants emphasize that it is frequently impracticable to select one particular power site for development without first investigating several, and that from an engineering standpoint the individual surveys are merely component parts of a single investigation which normally culminates in the development of a particular site or sites. On these grounds it is felt unreasonable to segregate and disallow any portion of the costs of preliminary investigations.

Similar situations frequently arise in other industries, in particular the forest products and primary industries.

(c) Payments made by a transportation company to certain municipalities to enable them to improve their local roads, the payments having been made as a condition of obtaining an order from a provincial Public Utilities Commission — *British Columbia Electric Railway Company v. M.N.R.* (Supreme Court, 1958).

(d) A commission paid by the purchaser of an exclusive distributorship to the vendor thereof at the rate of 2c per foot of the product sold — *No. 383 v. M.N.R.* (Tax Appeal Board, 1957).

(e) Travelling expenses of a taxpayer and his employee incurred on a trip made to acquire knowledge of a particular technique — *No. 470 v. M.N.R.* (Tax Appeal Board, 1958). This case raises the question of whether the cost of education should be deductible or depreciable. It also raises the question whether continuing education of individuals, such as professional men who require such education for the purpose of their businesses, or the education by an employer of its employees, should be distinguished from the initial basic education of an individual.

(f) The price paid to a contractor to acquire from him a construction contract — *No. 392 v. M.N.R.* (Tax Appeal Board, 1957).

(g) Landscaping costs are, in many businesses, a normal expense laid out for the purpose of the business but there is, at present, no provision for the deduction of such costs. Suitable landscaping is usually desirable from a public point of view as well as being of assistance to the business

concerned, and the amounts involved are generally of relatively minor importance.

(h) The price paid for a fixed period contract to purchase newsprint — *The Southam Co. Ltd. v. M.N.R.* (Tax Appeal Board, 1955).

(i) The cost of an underpass to connect the parts of a farm divided by a highway — *Hyland Farms Ltd. v. M.N.R.* (Tax Appeal Board, 1958).

Recommendation: It is recommended that a new prescribed class or classes be established under the capital cost allowances regulations to include any expenditures of a capital nature, except in respect of land, securities and goodwill, which:

(1) is incurred for the purpose of gaining or producing income within the meaning of section 12(1)(a), and

(2) does not result in the acquisition of depreciable property of an existing prescribed class.

EMPLOYER'S CONTRIBUTION TO PENSION FUND

Section 11(1)(g)

Where a company commences a pension plan at some time during its fiscal year, and pays the whole year's premium in advance it is possible that some part of such premium may be disallowed. If, for example, a company having a fiscal year corresponding with the calendar year introduced a pension plan on September 1 and paid a year's premium in advance, the Department could allow only one-third of the premium and disallow the remainder as not being in respect of services rendered during the year. Following the same theory disallowances could be made on the same basis each year in the future as the annual premiums are paid in advance.

Recommendation: It is recommended

that the words "or in the immediate preceding or immediately following year" be added after the words "in the year" in the fourth line of this provision.

RESERVES

Sections 12(1)(e), 85B, 11(1)(e), and 6(e)

The above are all the sections in the Act which deal with the subject of "reserves" in a general way; the very few other sections containing the word deal with special situations.

The word "reserve" and the use of it is of particular interest to the accounting profession because over a long period of time it has been used in a variety of different senses. These have been described in Bulletin No. 9 of the Committee on Accounting and Auditing Research of the Canadian Institute of Chartered Accountants. Reference should be made to the bulletin [a copy of which accompanied the brief] for a fuller discussion of the subject. However, it may be said that the original use of the word was for the appropriation of determined profits to provide for some future contingency as an indication that "undivided profits" were not to be considered fully available for distribution by way of dividends; this seems to conform with a traditional English practice of paying out in dividends substantially all of the recorded profits. Be that as it may, the modern use of the word "reserve" has come back to its original one of an appropriation of profits. As was said in the submission of this committee last year, "true 'reserves' in the accounting sense are held to relate only to amounts appropriated from net profits, after such profits have been ascertained; such appropriation may be made either at the discretion of

the management or pursuant to statutory or other requirements, e.g. general reserves, contingency reserves, reserves for possible future decline in inventory values, sinking fund reserves, etc. These reserves may normally be regarded as part of the shareholders' equity. This limitation in the use of the term 'reserve' is supported by terminology used in the recent revision of the Ontario Corporations Act and by accounting publications in Canada, United States and the United Kingdom."

From this, it follows that any credit balance created to provide for the diminution in the value of any assets, or for a liability whose amount cannot be determined accurately, is not properly called a "reserve". Parenthetically, the prime purpose of the process of accounting is the correct matching of costs against income and "provisions" in the accounts to bring this about should no longer be confused with "reserves". It is granted that the correct terminology is not always used, but the principle described is undoubtedly the correct one and that which receives general acceptance.

In the light of the foregoing, section 12(1)(e) can be said to be unobjectionable and in complete conformity with accounting precepts. The same may be said of sections 6(e) and 11(1)(e) except for the use of the word "reserve" which should be replaced by "allowance".

Section 85B, however, is a very different situation. It is suggested that this was an emergency provision which has served its purpose since it has succeeded in bringing many commercial and industrial taxpayers back to hard reality. What offends is the sweeping of everything into revenue,

the excessive emphasis on cash receipts and the misuse of the word "reserve". Section 85B, for example, brings into income deposits received on contracts under which no work has been done and on which no profit can have been earned.

Recommendations: In order to bring the Income Tax Act into conformity with accounting practices, while at the same time preserving the safeguards which the present scheme now contains, it is recommended that —

- (1) Section 85B be repealed;
- (2) The Crown rely more heavily on section 4;
- (3) Section 12 be amended to exclude specifically any allowances or types of allowances which are abhorrent to the Crown as being provisions for contingencies;
- (4) Sections 6(e) and 11(1)(e) be amended to replace the word "reserve" by the word "allowance";
- (5) Section 85I be amended where necessary to conform; or failing the foregoing, section 85B be amended so that the provisions for reasonable allowances are as broad as the provisions bringing the amounts into income.

UNPAID AMOUNTS

Section 12(3)

This provision was introduced in the 1949 revision of the Income Tax Act and did not appear in the law previously. It may cause serious inconvenience to taxpayers who have unpaid amounts for which there is a good business reason. In many cases, taxpayers are inadvertently trapped by this provision and incur additional taxes and interest. Recently, the provision has been applied to unpaid merchandise accounts.

Recommendation: It is recommended that the provision should not apply where the unpaid amount is included, in the year in which the debt was incurred, in computing the income of the person entitled to the payment.

HOLDING COMPANY EXPENSES Section 12(6)

It is sometimes convenient for a holding company to own real estate which is leased to the operating companies as well as owning shares of the operating subsidiaries. This procedure facilitates financing, bond issues, etc. It is suggested that companies in this position should not be denied the right to deduct the usual holding company expenses.

Recommendation: It is recommended that the words "or property leased to subsidiary - controlled corporations" should be inserted at the end of section 12(6).

It is further recommended that the principle inherent in section 12(6) be made applicable to section 11(1)(c), so that, in appropriate cases, interest paid by a holding company will be deductible even if the borrowed money is used to finance an investment in the capital stock of subsidiaries.

TRANSFERS TO SPOUSE, MINORS, Etc. Sections 21(1) and 22

These sections provide that where property is transferred from a taxpayer to his spouse or to a minor or trust, the income from the property shall be included in the income of the transferor in later years.

Recommendation: It is recommended that these provisions should apply only to the excess, if any, of the value of the property so transferred over

the value of the consideration received therefor.

HUSBAND AND WIFE Section 21(2) and (3)

These provisions disallow the deduction from taxable income of the remuneration paid to a wife who is employed by her husband or a partnership in which her husband is a partner.

Recommendation: It is recommended that the remuneration received by an employed spouse should be deductible and treated as separate income in the employee's hands, where the services are actually performed and the compensation is not greater than what would be paid to another person for the same services.

MEDICAL EXPENSES Section 27(1)(e)

The medical expense allowance is presumably designed to allow taxpayers a deduction for catastrophic or unduly severe medical expenses which have the effect of reducing income and which are uncontrollable. The section as presently written limits the amounts of expenses deductible and in many cases falls short of the original intention of the legislators.

Recommendation: It is recommended that the present restrictions on the maximum amounts allowable be rescinded.

BUSINESS LOSSES Section 27(1)(e)

As there are numerous taxpayers affected by taxing statutes of both Canada and the United States, it would seem advisable that sections concerning the carryover of business losses should be uniform wherever possible.

Recommendation: It is recommended that this section be amended so that business losses sustained in the five taxation years immediately preceding and the two taxation years immediately following the taxation year may be deducted.

DESIGNATED SURPLUS AND RELATED PROVISIONS

Sections 28(2) to (10), 85I, 105B and 105C

The introduction of the designated surplus provisions into the Act, and the piecemeal enactments to prevent taxpayers from escaping their consequences, have resulted in complication, confusion and uncertainty.

While designed to protect the revenue from loss of tax on the disappearance of undistributed income on a merger, the addition of section 105C in 1959 has lead many taxpayers to undertake mergers which might not have been thought of if the statute had not been changed to point the way. Furthermore, as the section has certain deficiencies, it has encouraged taxpayers to think that they need not be concerned about the tax consequences of merging as long as they are not caught by section 105C as it is now worded.

It would appear that every move made to tighten up the law merely results in the administration digging itself deeper into the bog.

Recommendations:

(1) It is recommended that a Royal Commission or a special committee be appointed to study the problems arising generally from the scheme of double taxation of corporations and corporate distributions and in particular from the designation of surplus under section 28(2) of the Act, with the object of suggesting a new approach.

(2) It is recommended that in the meantime:

(a) section 105C(1)(b) be amended to provide that, in addition to liabilities, the par or stated value of shares other than common shares of the new corporation immediately after the amalgamation be deducted from the value of the assets of the new corporation,

(b) section 105C(1)(a) be amended to provide for the deduction of tax-paid undistributed income,

(c) the undistributed income of the amalgamated company be reduced by an amount equal to

(i) the undistributed income in respect of which the 20% tax under this section is paid, minus

(ii) the said 20% tax,

or, alternatively, the said amount be added to the tax-paid undistributed income of the amalgamated company.

TWO FISCAL PERIODS ENDING IN THE SAME TAXATION YEAR

Section 37(2)

Section 37 of the Income Tax Act provides for alleviation of tax in the case of an individual or a partner where income taxable includes two or more fiscal periods ending within the taxation year. Subsection (1) provides for the case where, with the concurrence of the Minister under section 139(1)(r), a change is made in the fiscal period of the proprietorship or partnership. Subsection (2) provides for the situation where a single proprietor or a partner terminates business and enters employment, and finds himself reporting in the taxation year the income from the fiscal year of a business ending in that year plus compensation received from his new employment.

There is no provision in this section for the individual partner who terminates one partnership to enter another.

Section 15, as amended in 1959, may have been intended to give some relief in such a situation, but the effect is merely a postponement of tax, and is not a reduction in rates such as is effected by section 37. There seems to be no valid reason for discriminating between entry into employment and entry into a new partnership.

Recommendation: It is recommended that section 37(2) be amended to give the taxpayer entering a new partnership the same election as is available to one entering employment.

AVERAGING INCOMES OF FARMERS AND FISHERMEN

Section 42

Under section 42 the income of a farmer or fisherman may be averaged in five-year blocs in accordance with the requirements set out in this section, whence it follows that if a farmer or fisherman dies or retires from farming or fishing before an averaging bloc is completed there is no right to average his income for the period expired to the date of his death or retirement.

Recommendation: It is accordingly recommended that section 42 be amended to permit the income of a farmer or fisherman to be averaged for a shorter period than five years where the end of that period coincides with his death or retirement.

RULES RE ASSESSMENTS

Section 46(4)

Section 46(4) limits the time of reassessment to four years except in the case of fraud or misrepresentation. In several recent cases before

the Appeal Board it has been held that it is not necessary to send a notice of assessment to the taxpayer within the four-year period to make the reassessment valid. Instead it is only necessary that the assessment be completed within the four-year period. Under these circumstances it is impossible for the taxpayer to dispute the Department's statement as to when an assessment is made.

Recommendation: It is recommended that section 46(4) be revised to include a statement that the date of mailing of the notice of assessment or reassessment is the date of the assessment or reassessment, and to provide that an assessment whereby it is determined by the Minister that no tax is payable is an original assessment for the purposes of this section.

RULES RE ASSESSMENTS

Section 46(5)

This subsection gives the taxpayer the right to file an amended return for a taxation year within one year from the day when the return for that year was due for filing if he incurs a deductible business loss in the following taxation year.

Recommendation: It is recommended that this limit be extended to four years. (Compare with the Minister's rights under section 46(4) and refund provisions under section 57(1).)

WITHHOLDING

Section 47 and Part I of the Regulations

Section 47 imposes an obligation on every person making certain types of payments to withhold such amount as may be prescribed and to remit these amounts to the Receiver General on account of the payee's tax for the year under Part I of the Act.

The Provisions of Part I of the Regulations, which prescribe the amounts to be withheld, require withholding of tax from all payments of remuneration to employees, whether or not such employees are residents of Canada or otherwise liable to Canadian tax. In addition, the amounts required to be withheld from commissions paid to employee salesmen are based on the amounts paid even though the recipient may be required to pay substantial expenses out of the gross commission income. A similar situation exists in the case of payments made to non-residents in respect of services rendered in Canada, otherwise than in the course of regular and continuous employment. This would appear to apply not only in the case of employees but also to independent contractors performing services in Canada for a fee. In all such cases withholding is required on the basis of the gross amount paid for the services without regard to the expenses incurred in earning the revenue.

Recommendation: It is recommended that Part I of the Regulations should be amended to:

(1) Make it clear that withholding of tax is not required in the case of payments to non-residents for services not performed in Canada.

(2) Provide, in any other case of payment to non-residents, that the withholding requirements may be modified at the Minister's discretion on the ground of reasonableness rather than undue hardship.

PAYMENT OF TAX

Section 51(1)

It is acknowledged that taxpayers should not be able to finance themselves on unpaid tax money. However, because an assessment can im-

pose a very large liability requiring immediate payment, there should be some relief in a bona fide dispute. Generally, security will be accepted by arrangement with the Department; but this is not mandatory and the taxpayer may not have acceptable security. In addition, there is all too often a considerable delay after the hearing of an appeal before a decision is obtained which means that money of the taxpayer has been tied up and the 6% interest is not adequate compensation.

Recommendation: It is recommended that the statute be amended so that a taxpayer shall have the right to furnish security and the right to apply to a County or District Court Judge, an Exchequer Court Judge or a member of the Tax Appeal Board who may, if he considers that a bona fide dispute with the assessment exists, grant leave to postpone payment of the disputed tax pending the decision on appeal and who may rule on the adequacy of any security tendered by the taxpayer.

INTEREST ON TAXES

Section 54

Interest charged on income taxes is not allowed as a deduction in computing income. In the case of a corporation subject to the maximum rate of tax the interest of 6% per annum charged under this section represents an effective rate of 12% and a corporation subject to the lower rate of tax pays an effective rate of about 7.6%. In the case of an individual the effective rate can range from 6% up to 30% depending upon the rate of tax applicable.

In the great majority of cases an underpayment of tax is inadvertent and arises from honest error in the

application of a law which is extremely complex in many areas. It is unfair that a large majority of delinquent taxpayers should be severely penalized to catch the few cases where a taxpayer deliberately underpays his tax, and it is suggested that other means should be found to enforce payment by the latter group.

On the other hand, interest allowed on overpaid taxes is limited by section 57(3) to 3% and must be included in taxable income.

Recommendation: It is recommended that interest paid on income taxes (both Dominion and provincial) be allowed as a deduction in computing income, and that the rate of interest allowed on overpayments of income taxes should be the same as the rate charged on underpayments of tax.

DEDUCTION FOR CANADIAN TAX WITHHELD FROM TRUST INCOME

Section 63

Where a Canadian beneficiary receives income from a foreign estate or trust having income from Canadian sources that is subject to the 15% withholding tax in Canada, such income is subject to tax a second time in the return of the Canadian beneficiary with no provision for a tax credit in respect of the Canadian tax withheld at the source.

Recommendation: It is recommended that the tax withheld from his share of such income should be refunded to the Canadian beneficiary, or treated as a payment of his tax under Part I of the Act.

PERSONAL CORPORATIONS

Sections 67 and 68

The sections of the Income Tax Act pertaining to personal corporations are badly in need of revision and there is doubt as to whether

the present legislation fulfills the purposes of its enactment.

When the legislation was first introduced in 1926, Mr. Boivin, the Minister of Customs and Excise, stated: "We do say that they (the shareholders of a personal corporation) must pay the *same amount* of federal taxation as if they had continued as individuals."

We do not know of any reason why this principle should not continue to apply. However, due to the addition to the Act after 1926 of many new features, the shareholders of a personal corporation may in many circumstances either pay more or less tax than they would have paid if the income had been received by them direct instead of by the personal corporation.

There appears to be a number of defects in the formula in section 67(3) of the Act, with the result that there can be considerable distortion in the amounts apportioned to the various shareholders, and the provision designed to protect the Department can be used by the shareholders to achieve the tax advantages of income splitting between husband and wife or taxpayer and child.

There are a number of technical defects in section 67(7) and (8) relating to the part of an actually paid dividend required to be included in the income of a shareholder which should be remedied so that the law conforms with the intent.

Finally, it is thought that the penalty imposed by section 67(12) on a shareholder who controls a personal corporation, in the event that he fails to file with his income tax return "a statement of the assets, liabilities and income of the personal corporation for the year", is much too harsh for

the offence, particularly when circumstances do arise where neither shareholder nor the Department is certain as to whether a corporation is a personal corporation as now defined by section 68(1).

Recommendations: (1) It is recommended in order to assure that the shareholders of a personal corporation will pay the same amount of tax as if they had received the income direct, that:

(a) Sections 8(1) and 137 of the Act be made inapplicable to a benefit received by a shareholder from a personal corporation which has on hand no undistributed income accumulated before it became a personal corporation unless the effect of the transaction is to transfer equity from one member of the controlling family group to another.

(b) Section 137 of the Act be made inapplicable to a benefit conferred by a shareholder upon a personal corporation unless the effect of the transaction is to transfer equity from one member of the controlling family group to another.

(c) The shareholders of a personal corporation be permitted to deduct business losses and charitable donations which the personal corporation would be entitled to deduct under section 27 if it were not exempt from taxation under section 67(2), and that for this purpose a loss of the corporation be computed by including in the computation dividends otherwise deductible from taxable income under section 28. For this purpose, a "business loss" should include a loss resulting from carrying charges exceeding investment income.

(d) The shareholders of a personal

corporation be entitled to make an election under section 43 with respect to that part of the income, deemed to have been received by him from the personal corporation, which is recaptured depreciation included in income under the provisions of section 20(1).

(e) A corporate shareholder of a personal corporation be deemed, for purposes of section 28 of the Act, to have received its proportionate part of any dividends received by the personal corporation.

(f) A corporate shareholder of a personal corporation be deemed, for the purposes of section 41 of the Act, to have received its proportionate part of income received by the personal corporation from sources in a foreign country and to have paid its proportionate part of the tax paid by the personal corporation to a foreign country on its income from sources in that country.

(g) Where a corporate shareholder of a personal corporation, which previously had not been a personal corporation, is required to include in its income part or all of an actually paid dividend under the provisions of section 67(7), the corporate shareholder be deemed for the purposes of section 28 to have received the amount so included in its income as a dividend from a corporation which was not, by virtue of a statutory provision, exempt from tax under Part I of the Act for the year.

(h) Where a corporate shareholder of a corporation that is not a personal corporation, but previously had been a personal corporation, is required by section 67(8) to include only part of a dividend in its

income, the corporate shareholder be deemed for the purposes of section 28 to have received a dividend of only that part of the actual dividend which it is required by section 67(8) to include in its income.

(2) It is recommended, in order to clarify the provisions of section 67(7), that:

(a) Section 67(7)(a)(ii) be amended, by the addition of the *italicized words*, to read as follows:

"(ii) the aggregate of

(A) the amounts deemed under this section to have been distributed *on the last day of the taxation year in which the dividend was actually paid and during all preceding taxation years* while it was a personal corporation and

(B) *the amount of the corporation's tax-paid undistributed income minus any amount added thereto by virtue of section 82(6).*"

(b) Section 67(7)(b) be amended to make it clear that for this purpose undistributed income is to be reduced by the amounts previously included in computing the incomes of the shareholders by virtue of this paragraph and also by any part of the dividend in question which does not form part of the excess because of the application of tax-paid undistributed income suggested in paragraph (a) of this recommendation.

(3) It is recommended, in order to clarify and rationalize the apportionment rules, that section 67(3) be amended

(a) So as to exclude from property transferred or loaned by a shareholder of the personal corporation

(i) loans in respect of which a reasonable rate of interest has been paid by the corporation, and

(ii) loans and capital or the part thereof repaid before the commencement of the year.

(b) To provide that where a person transfers less than all of the shares originally owned by him, the value of the property transferred or loaned to the corporation by the transferee shall be deemed to be that part of the value of the property actually transferred or loaned to the corporation by the transferor that the number of shares transferred bears to the total number of shares originally held by the transferor, and that if the transferor continues to be a shareholder the value of the property transferred or loaned by him to the corporation shall be reduced by the amount so deemed to have been transferred or loaned to the corporation by the transferee.

(c) To provide that if the corporation issues additional shares after substantial time has elapsed since shares were last previously issued, the value of the property transferred or loaned by the holders of the previously issued shares, or their predecessors, shall be increased or decreased by the amount of the increase or decrease in the shareholders' equity since the issue of their shares, including in the computation of such equity the amount of any increase or decrease from book values in the fair market value of marketable securities, other investments and property of the corporation.

(4) It is recommended that the penalty imposed by section 67(12) be repealed and that the Minister rely upon the ordinary penalties for non-filing and evasion under sections 55 and 56.

(5) It is recommended that the definition of a personal corporation contained in section 68(1) of the Act be amended by deleting the words "or trading or dealing in" from paragraph (b)(i).

FOREIGN BUSINESS CORPORATIONS

Section 71

Following the invitation extended by the Minister of Finance the committee has considered the position created by the withdrawal of the right to establish new foreign business corporations after April 9, 1959.

The committee is of the view that foreign business corporations have brought Canada some obvious advantages and no substantial disadvantages. Among the benefits are the employment of Canadians and the lodging of investment funds in this country.

Having studied the various explanations given by the Minister and the officials the committee has concluded that the principal concern leading to the amendment was the possibility of withdrawing accumulated funds from Canada without payment of the withholding tax by a change of status from that of resident to non-resident prior to the withdrawal. Since safeguards can be devised to overcome this difficulty the committee is of the opinion that Canada should continue to enjoy the advantages derived from foreign business corporations under an appropriately revised law. Other amendments to section 71 may also be felt necessary to clarify the wording in certain respects.

Recommendation: It is recommended that section 71 be re-enacted with amendments to assure payments of the tax on undistributed income in the event that the corporation

changes to non-resident status and to make such other changes as are necessary for clarification.

PROFIT SHARING PLANS

Section 79(6)

Some clarification of section 79(6) would be in order. In many profit sharing plans a withdrawing member will receive payment from the trustee equal to the market value of his share of the funds in the hands of the trustee. He may receive payment in cash or if the funds are invested in the stock of the employer company, he may receive a number of shares. In any event, it is attributed to payments made by him, amounts on which he has already paid tax or to capital gains made by the trust. This excess may be wholly attributable to appreciation in market value of trust holdings which, if liquidated by the trustee, would produce a non-taxable capital gain.

Recommendation: It is recommended that the withdrawing member should not be required to pay tax on payments which he receives in respect of unrealized capital gains of the trust.

WHERE PAID-UP CAPITAL INCREASED

Section 81(8)

A strict reading of this section would appear to mean that the conversion of debentures and other liabilities into capital stock with a resulting increase in the paid-up capital would be deemed capitalization of undistributed income. The shareholders would be taxable to the extent of this capitalization. It does not seem reasonable that this should be the case and with the number of convertible debenture issues of the last few years it could be a matter of considerable importance.

Recommendation: It is recommended that a revision be made to add to subsection (8)(b) following the word "assets" "and/or reduced the liabilities", thereby giving sanction to what is understood to be the prevailing practice.

DRILLING COSTS

Section 83A and Regulation 1204

There appears to be an anomaly in the Income Tax Regulations which denies to certain corporations the right to deduct drilling costs of an oil or natural gas well inside Canada while at the same time they may, under section 1204(1), deduct similar costs of a well outside Canada from the income of the well.

Recommendation: It is recommended that the Regulations should be amended to provide that all corporations may deduct drilling costs of a well inside Canada from the income of that well.

DEDUCTION OF DRILLING AND EXPLORATION EXPENSES BY ASSOCIATIONS, ETC.

Section 83A(4)

Persons who enter more than one association, partnership or syndicate formed for the purpose of exploring or drilling for petroleum or natural gas find that taxwise they are in a unique position. If one association fails to be successful or to find production, the excess expenditure can neither be charged off against other income of any type whatsoever nor can it be offset against an excess of income over expenses in another association formed for the same purpose. Normally a taxpayer who loses money in one business venture can offset that loss if he has made a profit in another business venture in the same taxation year. Here a tax-

payer may have an interest in two ventures in exactly the same type of business but cannot match excess expense against excess income.

Recommendation: It is recommended that provision be made under section 83A(4) for each member of an association, partnership or syndicate formed for the purposes of exploring for petroleum or natural gas to segregate his share of income and expense and be permitted to consolidate such income and expense from two or more such similar ventures.

BAD DEBTS

Section 85I(2)(f)

Since the amalgamated company is deemed to be a new corporation for tax purposes, there does not appear to be any provision that would require it to include in its income bad debts written off by a predecessor corporation.

Recommendation: It is recommended that the Act be amended to remedy this omission.

RETIREMENT SAVINGS PLAN — PREMIUMS OVERPAID

Section 79B(5)

The deduction allowed for premiums paid under a retirement savings plan is limited to the lesser of \$1,500 or 10% of earned income in the case of a taxpayer participating in an approved pension plan and \$2,500 or 10% of earned income in the case of any other taxpayer. In some situations the amount of earned income cannot be determined until the end of the year. If the taxpayer has overpaid his premiums during the taxation year no deduction is allowed for the overpayment; on the other hand, if the overpayment is made after the end of the year it may be claimed in the next following year.

Recommendation: It is recommended that the taxpayer should be permitted to carry forward an overpayment of premiums under a retirement savings plan for use as a deduction in the following year.

EXPLORATION EXPENSES

Section 85I(3)

No provision is made in this subsection for the deduction by the amalgamated company of certain exploration expenses which would otherwise have been deductible in a predecessor company.

Recommendation: It is recommended that:

(1) Exploration expenses eligible for deduction by a predecessor under section 83A(8a) should be made eligible for deduction by the new corporation.

(2) Bonus payments for oil or gas leases eligible for deduction by a predecessor under section 83A(6) should be made eligible for deduction by the new corporation.

(3) Drilling expenses outside Canada and exploration expenses for coal and certain other mines which would qualify for deduction by a predecessor under Regulation 1204 or 1205 should be made eligible for deduction by the new corporation.

TAX ON UNDISTRIBUTED INCOME

Section 85I(4)

Subsection (4) provides special rules enabling the amalgamated corporation to elect to pay the 15% tax under sections 105(1) and 105(2). However, no such rules are provided for amalgamated companies wishing to elect under sections 105(1a), 105(2a) and 105(2b).

Recommendation: It is recommended

that the Act be amended to remedy this omission.

REVOCATION OF ELECTION TO BE TAXED ON 1949 SURPLUS

Section 105

Under this section when a corporate taxpayer elects to pay a tax on its 1949 undistributed income, it becomes liable for any additional tax that may be found payable on assessment.

The computation of undistributed income in many cases goes back as far as 1917 and frequently there are unknown or doubtful items, some of which may be quite material. An example might be where substantial additions are made to the undistributed income arising from surpluses transferred from predecessor companies of which the taxpayer may have had no knowledge.

Because of the possibility of material differences arising in the computation of undistributed income due to unknown factors, the difficulty of adequately determining all the facts of particular transactions after a number of years, the existence of differences of opinion on interpretation of the law, and the possibility of honest errors, a large additional amount of tax may be assessed that the taxpayer is unable or unwilling to pay.

Recommendation: It is, therefore, recommended that the taxpayer be given the right to revoke an election and recover tax already paid under this section where the assessed tax exceeds the estimated tax by more than a prescribed percentage.

ELECTIONS IN RESPECT OF DEEMED DIVIDENDS

Section 105(2) and (2a)

A stock dividend, deemed by sec-

tion 81(3) to be a dividend, qualifies, to the extent that it is not excluded from income by sections 81(4) or 141(1), as a dividend for the purposes of elections under section 105(2) and (2a), whereas dividends deemed to have been received by section 81(1) and (2) do not.

Recommendation: It is recommended that sections 105(2)(c)(ii) and 105(2a)(c)(ii) be amended so as to include all dividends deemed to have been received by section 81 to the extent not excluded from income by virtue of sections 81(4) or 141(1).

ELECTIONS BY OTHER SUBSIDIARY-CONTROLLED CORPORATIONS

Section 105(2b)(c)

The wording of section 105(2b)(c) leaves some question as to whether the rights granted in subsection (2b) would be denied unless the company had elected on its 1949 undistributed income prior to the time when the company became a subsidiary-controlled corporation.

Recommendation: It is recommended that it should be made clear that the right to elect on the basis of post-1949 dividends paid prior to the corporation becoming a subsidiary-controlled corporation will not depend on whether the company had the right to elect on those dividends immediately prior to becoming a subsidiary-controlled corporation.

ELECTION BY OTHER SUBSIDIARY-CONTROLLED CORPORATIONS

Section 105(2b)

The amount on which a subsidiary-controlled corporation may elect to pay a 15% tax is restricted to dividends paid in the taxation years beginning with the 1950 taxation year and ending with the last taxation year

immediately preceding the taxation year in which it became a subsidiary-controlled corporation.

Recommendation: It is recommended that section 105(2b) be amended to include in the amount on which a subsidiary-controlled corporation may elect to pay tax such dividends paid in the taxation year in which it became a subsidiary-controlled corporation as were paid prior to the date on which control is acquired.

PENALTY FOR FAILURE TO WITHHOLD TAX

Section 123(8)

Under this subsection the penalty for failure to withhold tax (or amounts on account of tax) from payments to non-residents is 100% of the amount that should have been withheld plus interest at 10% per annum. This penalty is ten times the penalty for failure to withhold from payments to residents and is altogether too severe — particularly so as many cases of failure to withhold will arise from unfamiliarity with the requirements of the Act or Regulations while others will arise from lack of knowledge that the payee is in fact a non-resident. If the basic purpose is to guard against loss of revenue this purpose might better be accomplished by a provision making the resident payor jointly liable for the tax of the non-resident, up to the amount that should have been withheld, than by imposing a savage penalty the collection of which does not seem to reduce the non-resident's liability for payment in any way.

Recommendation: It is recommended that the penalty for failure to withhold from payments to non-residents be reduced to the level considered ap-

proper for failure to withhold from payments to residents, and that the resident payor be made jointly and severally liable with the non-resident payee for the tax which is required to be withheld.

ARM'S LENGTH — IRREBUTTABLE PRESUMPTION

Section 139(5)

Section 139(5) provides that related persons shall be deemed not to deal with each other at arm's length and that it shall be a question of fact whether persons not related to each other were at a particular time dealing with each other at arm's length. It is submitted taxpayers should not be subject to taxation in Canada on the basis of relationships which are conclusively presumed to exist but which in many cases do not in fact exist. This principle has now been recognized in the Estate Tax Act (section 28) where a deceased person and persons related to him are treated as not having been dealing at arm's length unless it is established that they were persons dealing at arm's length.

Recommendation: It is recommended that, in place of the irrebuttable presumption that related persons as defined by section 139(5a) to (5d) and (6) do not deal with each other at arm's length, the Act should provide that they shall be *presumed* not to deal with each other at arm's length so that the taxpayer may have the opportunity of rebutting the presumption by evidence satisfactory to a court of law.

CASES WHERE SALARIES AND WAGES ARE NOT AN IMPORTANT FACTOR

Regulation Part IV

In the case of a number of com-

panies, such as real estate holding companies which may have very few employees in relation to the size of the undertaking, the use of the salaries and wages ratio in the allocation formula may produce a very unrealistic result.

Recommendation: It is suggested that companies falling into this category might be dealt with in the same manner as trust and loan corporations under section 405 of the Regulations.

TAXABLE INCOME EARNED IN PRESCRIBED PROVINCE

Regulation Part IV

Under the present regulations the whole of the taxable income of a Canadian taxpayer carrying on business abroad is subject to allocation for purposes of computing the provincial tax credit under section 40 of the Income Tax Act on a formula basis. In its tax treaties with foreign countries Canada has adopted the principle that taxable income earned in Canada and abroad should be determined primarily on a separate accounting basis. Furthermore, provision is made in the Ontario Corporations Tax Act for use of the separate accounting method in these circumstances and it is desirable to adopt a uniform method of determining the taxable income for federal and provincial purposes.

Recommendation: It is recommended that Part IV and Part XXVI of the Income Tax Regulations be amended so that where the person is resident in Canada the taxable income allocated would exclude the income or loss attributable to the permanent establishments outside of Canada for the purposes of section 41 of the Income Tax Act and that only the remainder be allocated on a formula basis to permanent establishments in Canada.

LEASEHOLDS, PATENTS, FRANCHISES, CONCESSIONS, LICENCES

Regulation 1100(1)(b)

Under regulation 1100(1)(b) the capital cost allowance for leasehold property is computed separately in respect of each property and on a straight-line basis, although all of such leasehold property constitutes one class under class 13 of schedule B. The same is true under regulation 1100(1)(c) of patents, franchises, concessions and licences described in class 14 of schedule B. Under section 20(1) and regulation 1100(2), however, all of a taxpayer's property of one of the classes described is lumped together for the purpose of recapturing capital cost allowances and claiming a terminal allowance.

Recommendation: It is recommended that a taxpayer have the right to elect that any item of property described in classes 13 and 14 of Schedule B constitute a separate class so that the recapture and terminal provisions, as well as the percentage deduction provision, *may* apply to such property separately and that, once an election is made, it be binding on the taxpayer and not changeable except with the consent of the Minister.

ADVANCE TAX RULINGS

There is considerable merit in a system which permits a taxpayer to predetermine his liability for tax under a given set of circumstances when the tax consequences are such that they would affect his course of action. Both taxpayers and Department officials in the United States, where the revenue service has a department to give advance rulings on the request of a taxpayer, find the system workable and advantageous.

The following advantages would

accrue to taxpayer and Department:

(1) Advance knowledge of tax liability arising out of the specific transaction reduces business risk and thereby tends to encourage investment and business activity.

(2) Advance rulings tend to provide certainty as to the law and thereby aid business and other elements of the economy upon the normal activity on which the tax system is dependent.

(3) An advance ruling tends to discourage transactions which are likely to result in expensive and fruitless tax controversies.

(4) An advance ruling facilitates the correct computation of taxes by taxpayers and thereby promotes voluntary compliance.

(5) Requests for advance rulings are an important source of information as to the tax-thinking of taxpayers and tax practitioners for the assistance of the authorities and laying the ground work for fair and economical tax administration.

(6) Requests for advance rulings facilitate the work of assessment by providing information much earlier than would otherwise be obtained.

(7) Publication of such advance rulings when of general application would promote uniformity of assessment and avoid multiplicity of applications on the same point.

Recommendation: The following recommendation is made:

(1) That the Income Tax Act be amended to authorize the Minister of National Revenue through his designated officers to make advance rulings on the request of taxpayers as to the tax assessment which would result from specific prospective transactions.

(2) That in setting up the neces-

sary administrative machinery the following principles be adopted:

- (a) One central agency should be responsible for all advance rulings.
- (b) Advance rulings should be issued only for specific prospective transactions based upon full disclosure of all relevant facts and of all business reasons therefor, and, where of general application, should be published.
- (c) For all assessing purposes, an advance ruling should bind the Department of National Revenue against making any assessment less favourable to the applicant, where:
 - (i) there has been no misstatement or omission of material facts on the application;
 - (ii) the facts subsequently developed are not materially different from the facts on which ruling was based;
 - (iii) there has been no change in the applicable law;
 - (iv) the taxpayer has acted in good faith in reliance on the ruling and a retroactive revocation would be to his detriment.
- (d) Any advance ruling should be without prejudice to any of the rights of the applicant.

Accounting Research

CONSOLIDATED FINANCIAL STATEMENTS

The Committee on Accounting Procedure of the American Institute of Certified Public Accountants issued its Accounting Research Bulletin No. 51 last August. This bulletin deals with consolidated financial statements and represents the first attempt of the American committee to deal with this subject exhaustively. Because American official pronouncements on accounting matters usually have considerable influence on Canadian practice, despite the regrets of many Canadians, some familiarity with the American views seems desirable for Canadian practitioners. In this article, the more important recommendations are considered and compared with existing Canadian practice.

Some of the questions dealt with in Bulletin No. 51 are not relevant to Canadian conditions, and some of the proposals made are so generally accepted that further discussion seems unnecessary. There are, however, a number of points on which Canadian opinion is by no means clear or where Canadian practice seems to be different from the recommended American procedure.

In addition, the new bulletin includes a careful review of the problems involved in reporting the profits or losses of non-consolidated subsidiaries. Because this is a complex question involving Canadian legal requirements as well as accounting con-

cepts, and not strictly part of the problem of consolidation, its discussion is postponed to a later issue.

Consolidation Policy

In recent years, there has been increasing acceptance of the idea that consolidated financial statements are necessary for fair presentation of the condition and results of parent-subsidiary groups of companies. This change in the status of consolidated statements from a permissible alternative to the preferred and recommended method is reflected by the change in the attitude of the C.I.C.A. Committee on Accounting and Auditing Research. In its Bulletin No. 1, issued in 1946, the committee expressed no views on the general desirability of presenting consolidated statements but confined itself to discussing the standards of disclosure applicable where consolidated statements were provided. On the other hand, Bulletin No. 14, replacing Bulletin No. 1 in 1957, stated that "a consolidated statement should be presented whenever it presents the most informative view".

There is a similar change in the attitude of the provincial Securities Commissions which have become more reluctant to accept non-consolidated statements in prospectuses filed with them. Company law in Canada has not yet gone as far as the United Kingdom Companies Act of 1948

which made the submission of "group accounts" compulsory, but a move in the same direction is indicated. The Ontario Corporations Act, 1953 and the proposed uniform Companies Acts have put an increasing burden of disclosure on companies preparing non-consolidated statements.

In the United States, the trend towards insistence on consolidation has progressed further than in Canada. The S.E.C., for example, has for many years required consolidated statements in all but a very few of the applicable cases, and American companies have accepted this ruling as an accurate reflection of generally accepted opinion by providing consolidated statements even where the S.E.C. rules are not relevant. Perhaps for this reason the American Institute has not previously felt it necessary to express an opinion on the general desirability of consolidation. Even the present bulletin seems to take for granted the general acceptance of consolidation as the best method of presentation. It states, "There is a presumption that they [consolidated statements] are more meaningful than separate statements and that they are usually necessary for a fair presentation when one of the companies in the group directly or indirectly has a controlling financial interest in the other companies."

It seems that the principal concern of the American committee has been to discourage the practice of omitting subsidiaries from consolidation for what are considered inadequate reasons. Consolidated statements are recognized as inappropriate where control is temporary or does not rest with the owners of the majority interest as, for example, in case of bankruptcy or reorganization.

Where permanent control exists, however, the acceptable reasons for omissions from consolidation are severely restrictive, especially when compared with the Canadian standards described in C.I.C.A. Bulletin No. 14.

Unlike the Canadian bulletin, the American bulletin recognizes that there may be cases "where the minority interest in a subsidiary is so large, in relation to the equity of the shareholders of the parent in the consolidated net assets, that the presentation of separate financial statements for the two companies would be more meaningful and useful". On the other hand, the American attitude towards the existence of a substantial indebtedness in the subsidiary is the direct opposite of the Canadian. Bulletin No. 51 states, "The fact that the subsidiary has a relatively large indebtedness to bondholders or others is not in itself a valid argument for exclusion of the subsidiary from consolidation" while Bulletin No. 14 recognizes this situation as one of those in which a fairer presentation may be made if the accounts are not consolidated.

Both committees agree on the exclusion of foreign subsidiaries where exchange or other restrictions makes the withdrawal of the subsidiary's assets problematical. This question is not actually dealt with in Bulletin No. 51, as it was the subject of a previous release now consolidated in Bulletin No. 43.

On the question of exclusion of subsidiaries whose operations differ from those of the rest of the group, the American rule is again more restrictive. The Canadian Bulletin No. 14 suggests that fairer presentation may often be obtained by non-consolidated statements "where the op-

erations of the subsidiary differ in nature from those of the other companies in the group". From its statement that "even though a group of companies is heterogeneous in character, it may be better to make a full consolidation than to present a large number of separate statements", the American Institute apparently feels that an unusual divergence of activities is required to justify exclusion. The use of banking, insurance, or finance subsidiaries of manufacturing companies as examples of exceptions seems to confirm this interpretation.

No recognition is given in the American bulletin to the other reasons for exclusion mentioned by the Canadian committee, viz. a relatively large issue of bonds or debentures of a subsidiary not guaranteed by the parent or another subsidiary, or a resulting distortion from including a subsidiary having a very strong or weak position.

Treatment of Inter-Company Profits

Bulletin No. 14 restricts itself to the general statement that "proper adjustment should be made for . . . inter-company profits on assets transferred within the group (inventories, fixed assets, etc.)". Since it is primarily concerned with disclosure and not with accounting problems, it does not contain detailed comments regarding the technical problems involved in making these eliminations. The American bulletin, however, makes it clear that the gross profit is to be eliminated and that the amount of profit to be eliminated is not affected by the existence of a minority interest in such inter-company profits. The proposal frequently put forward by text book authors and other theorists to the effect that only the majority interest in profits or losses

made on sales to the parent need be eliminated is rejected on the grounds that the object of consolidation is to present the financial position and results of a single enterprise and that the consolidated statements must not, therefore, be affected by inter-company transactions. The apportionment of the eliminated profit or loss between the majority and minority interests is, however, recognized as acceptable.

This treatment evidently means that in the case of inventory sold to the parent company, for example, the whole of the gross profit on the sale is to be eliminated from the inventory while the consolidated profit (and earned surplus) is only to be reduced by the amount of the majority share of such profit. The balance of the profit eliminated from inventory would then be deducted from the minority interest. This treatment results in carrying the inventory at cost to the group but avoids the inconsistency of eliminating the whole profit from consolidated earnings when only the majority portion has actually been reflected there.

Differences between Cost and Book Values

Bulletin No. 14 recommends that the difference between the cost of subsidiary shares to the parent company and the net equity of the parent in those shares at the date of acquisition should be shown separately, unless it has been disposed of by a procedure disclosed at the time of disposition. The American bulletin, on the other hand, provides that the difference "should be disposed of according to its nature". More specifically, it provides that "to the extent that the difference is considered to be

attributable to tangible assets and specific intangible assets, such as patents, it should be allocated to them". Only the balance that cannot be so allocated is permitted to be shown as a separate item under "one or more appropriately descriptive captions".

This seems to reflect a complete difference in emphasis between the two committees although it may be that Bulletin No. 14 does not intend to imply that separate presentation is preferable, and that it is meant to be impartial on this point. It does seem clear, however, that the American committee is definitely in favour of the specific allocation of debit discrepancies and regards the specific description of an unallocated purchase discrepancy as an inferior method. The omission of any reference to "goodwill" suggests that this formerly almost automatic classification of such differences is no longer viewed with much favour.

A similar treatment is proposed for credit discrepancies, with the same preference for specific allocation of the difference to write down specific over-valued assets. Only in "unusual circumstances" is the existence of an unallocated credit account necessary. The amount of such credit should be taken into income in future periods on a "reasonable and systematic basis". It is further stated that the former practice of carrying such items to capital surplus can no longer be considered acceptable. The practice of showing this item as part of shareholders' equity under some caption other than capital surplus is not discussed. The general tenor of the bulletin, however, makes it virtually certain that this common Canadian practice has been ignored, not because it is acceptable, but because it

is considered to be so clearly inappropriate that no specific prohibition is needed.

Surplus and Profits Prior to Acquisition

Both bulletins agree with the generally accepted principle that earnings and surplus of a subsidiary arising prior to acquisition must be eliminated on consolidation. The American bulletin, however, introduces some ideas regarding the determination and disclosure of these amounts which may surprise Canadian practitioners. Where the control has been acquired in steps, Bulletin No. 51 indicates a preference for including the earnings attributable to the blocks of shares acquired prior to control in earnings of the year in which control is finally acquired and in accumulated earned surplus. The operation of this proposal is illustrated by an example in which a 45% interest in a company is acquired on October 1, 1957 and a further 30% on April 1, 1958. It is suggested that the earnings reported for the year ended December 31, 1958 should include 45% of the earnings for the first three months and 75% of the earnings for the remainder of the year and that an amount equal to 45% of the subsidiary profit for the period from October 1 to December 31, 1957 should be transferred to earned surplus.

Another proposal which may be surprising to Canadian practitioners involves including in the reported consolidated earnings all the subsidiary's profits for the year in which control is acquired. The proper consolidated earnings would then be obtained by deducting the pre-acquisition earnings of the subsidiary at the bottom of the statement as part of the

minority interest in profits for the year. This method is considered to be preferable to the more usual procedure of including only profits since acquisition, on the grounds that it presents results more indicative of the current status of the group and provides a better basis for comparison of gross revenues etc. with subsequent years.

General

Both the Canadian and American bulletins recognize the necessity, in many cases, of presenting the non-consolidated financial statements of the parent company together with some or all of the statements of the subsidiaries. The American bulletin suggests the use of "consolidating statements" as one method of doing so. These statements are described as columnar ones in which separate columns are provided for the consolidated figures, for those of the parent company, and for particular subsidiaries or groups of subsidiaries.

Two matters dealt with in Bulletin No. 51 do not seem relevant to Canadian conditions: the need to provide for taxes payable on transfer of profits to parents, and the treatment in the parent of subsidiary stock dividends. In the former case, the problem of taxes payable on subsidiary dividends is important only in respect of foreign subsidiaries. The peculiarly Canadian problem of the effect of potential tax on "designated surplus" is not, of course, dealt with, although it is a subject to which Canadian accountants should give some thought.

In general, the American position on consolidated statements is not greatly different from our own. The major differences involve the more restricted recognition by the Amer-

icans of circumstances justifying the exclusion of subsidiaries from consolidation, their preference for the allocation of purchase discrepancies to specific assets and their rejection of the practice of showing credit discrepancies as part of shareholders' equity. Canadian accountants have, of course, no obligation to follow American rules. When differences such as these do arise, however, prudence suggests that we should review our own position in order to be sure that it is defensible on grounds other than tradition.

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Irving L. Rosen, in his article published in Accounting Research last month, criticized certain of the pronouncements of the Committee on Accounting and Auditing Research, primarily on the grounds that Bulletin No. 16 did not go far enough. In the same issue, a letter to the Editor from Mr. J. M. Dever voiced concern about the ideas expressed in one of the articles in this section. These signs of interest are welcome, in the opinion of the editor of Accounting Research. They promote discussion of the activities of the Committee on Accounting and Auditing Research and excite controversy over unsettled questions. That the Research Committee also enjoys the comment is shown by the following letter from Howard I. Ross, the committee chairman:

Montreal, Jan. 8, 1960

Sir: At the recent C.I.C.A. conference in Vancouver, I had occasion to remark that the Research Committee leads a somewhat lonely life. Our pronouncements have rarely provoked much response from our members, and the committee has thus been left

pretty much to rely on its own insights. It was most encouraging to note in your section recently evidences of interest in the work of the Research Committee in the form of criticism of our pronouncements.

We have received several thoughtful letters from members examining our bulletins in the most penetrating way. It is some comfort to the committee to find that our critics are fairly evenly divided between those who feel we tend to rush in too fast and those who feel we should get a move on; those who deplore that we are not keeping up with our American friends and those who do not believe we should even follow them; those who consider we should not speak in

such a pontifical manner and those who scold us for not lecturing to the profession at much greater length (we have even been accused of brevity).

It may just be possible that this means we are hitting some kind of medium (perhaps even a happy one) between the strongly conflicting views of our members as to what the committee's functions should be. The more suggestions we get, the better we will be pleased and, what is more to the point, the more effectively we are likely to work.

HOWARD I. ROSS, C.A.
Chairman,
C.I.C.A. Committee on
Accounting and Auditing Research

Subject to the Foregoing

When a young Toronto chartered accountant was sent to a small Ontario town on an audit of the municipality, he came across the following audit report affixed to the 1894 financial statements of the town:

"We have found a great deal of difficulty in auditing your accounts on account of the want of system in all matters pertaining to the business of the town, and the poor system recommended by the Council and adopted by the Clerk in the keeping of the ledger and cash books, so that a close check is impossible to be kept on the different town officials. We would suggest that an entirely different system be adopted, and that the books be furnished the Clerk to enable him in the future to keep a clean set of books, and intelligible to anyone without the presence of the Clerk, without whom it is at present impossible to obtain any insight whatever into the affairs of the town, so that should anything happen to him, it would leave the town in a bad condition indeed."

Our informant says that in 1895, the town did get a new system, and it also had a new firm of auditors!

Practitioners Forum

CONFERENCES AND CONTINUING EDUCATION

Today, post-graduate education is being considered seriously by the accountancy profession. The need for continuing education is widely acknowledged. Technical advances have increased the problems of management, and they are relying more on accounting. Presumably this trend will continue, and we can expect that more extensive educational programs will be required.

There is a need for material on income tax, and the Canadian Tax Foundation, and the Canadian Institute and various Provincial Institutes are active in providing it. There is also a need for material on accounting and auditing. Here the accountant in a small firm has nowhere to go but to his Institute. In recognition of this need, the Canadian Institute of Chartered Accountants has appointed a Committee on Continuing Education.

The wide field of post-graduate studies is being tackled seriously in a few areas now. *The Canadian Chartered Accountant* is one medium available to all. The technical sessions at the C.I.C.A. and provincial conferences are available to most members. From the standpoint of their usefulness as a means of educating our members, our conferences have a current appeal, but perhaps they can be made even more effective. We can use as a yardstick for comparison

a conference held annually in Michigan.

Michigan Conference

I attended the 12th Accountants Graduate Study Conference at the University of Michigan in June 1959. This conference is acknowledged to be one of the most successful of the many regional conferences held in the United States. An article by Wayne B. Wagar, C.P.A. in *The Journal of Accountancy*, May 1958 describes the organizing, attendance and selection of subject matter for the first ten of these conferences.

Presented by the Michigan Association of C.P.A.'s, the conference is jointly sponsored by the School of Business Administration, University of Michigan and the American Institute of Certified Public Accountants. It has been designed specifically for the small and medium-size practitioner rather than for the broader audience of our Canadian conferences.

The charge for accommodation and all meals of the June 1959 conference was \$40, which is quite reasonable for three days. The conference was self-supporting. The members in attendance all lived in residence at the university, and the general atmosphere was very much like that of a campus. Each student was issued with a notebook containing outlines of some of the talks, ample sheets of

blank paper to encourage note-taking, and a complete list of the registrants by groups.

The conference ran from Tuesday at 6 p.m. to Friday noon. One half day was allotted for each topic. The topics were "Evaluation of the Professional Employee", "Expanding and Maintaining Your Practice", "The Auditor's Responsibility for Evaluating Internal Control and Testing for Fraud Implied in the Standard Accountant's Opinion", "Measuring and Upgrading Compliance with Auditing Standards", "Taxation - What's in the Future?". The three evenings were taken up with registration, a banquet, and a "bull session".

The general pattern of each session was similar. The entire group, approximately 140, listened to a talk for about 50 minutes. One speaker used half his time to present a case study. In another instance, a panel introduced the subject. After a ten-minute break, the students split into groups of 20 to 25, but no larger, for from 45 to 60 minutes of discussion.

The role of the discussion leaders was to generate comment from the group. They avoided expressing their own opinions and rotated among the groups so that the members had a different one each time.

The discussion leaders were very carefully chosen. Of the six C.P.A.'s, five had experience teaching at universities. An indication of the importance attached to the role of discussion leaders was that one of them was Professor William A. Paton from the University of Michigan. During the discussion, the speaker visited each group for five or ten minutes and answered questions.

After another ten-minute break, all the students reconvened. Each dis-

cussion leader reported the findings of his group and, in some cases, questioned the speaker. This took about 30 minutes.

The morning sessions ran from 9:30 a.m. to 12 noon, the afternoon sessions from 1:30 p.m. to 4:30 p.m.

The get-together on Thursday evening was most informal. There were three groups of about 40 members. Personally I did not consider this type of meeting as valuable as the more formal sessions during the day.

This program, originally guided by the American Institute, is run by a committee of the Michigan Society and arranged in cooperation with the faculty at the University of Michigan. Continuity is maintained on the committee. The member from the university provides liaison for arranging accommodation and advises on technical aspects, although these are pretty well established now. Planning for the conference is done many months in advance so that the selection of discussion leaders and speakers can be done carefully.

The professional touch was very noticeable in the way the conference was timed and conducted. Time was given to explore a topic fully. Ample scope was given for participation by the members. There were no interruptions during the day for coffee breaks or "refreshments". The evenings provided adequate opportunity to relax.

The calibre of the speakers and the material presented were on a par with our Canadian conferences. There was, however, decidedly more emphasis on education.

Canadian Conferences

The general pattern of the technical sessions at the C.I.C.A. annual

conferences has been the same for several years, although there were some changes in 1958. The format has been successful and has generally met with the approval of those attending.

At the 1958 conference in Montreal, the key-note speakers, on Monday morning, were outstanding businessmen well worth listening to. The afternoon panel discussions maintained interest by having a variety of speakers express divergent views. The content of the material was good and the participants well-qualified.

On Tuesday, the "educational" program was launched with three topics offered: "Management Controls" for accountants in industry; "Accounting and Auditing Research" for those in public practice; and "Taxation" of interest to most accountants.

On Wednesday, the same topics were continued at the University of Montreal. They were organized as discussion groups, there being no previous opportunity for audience participation. The amount of discussion varied. While the leaders were equipped to talk about the subjects presented, some of them had little experience in handling discussion groups, and as a result were not effective. Accordingly, the benefits were much less than the potential inherent in the material. The technique of leading a discussion group is a difficult one to master, and is not acquired without considerable training and practice. It is probably not reasonable to expect chartered accountants, other than university professors, to be competent in this role.

Comparison

A direct comparison of the Michigan conference and the C.I.C.A. con-

ference cannot be made. The objectives of the latter, where wives are in attendance, are much broader, and the C.I.C.A. conference caters to a substantially larger number of people. The publicity value, the opportunity for social get-togethers and the excellent papers which originate at a C.I.C.A. conference are its primary aims, and these have been achieved.

The number of discussion leaders required for a conference with 500 members in attendance makes it impracticable to run a C.I.C.A. conference the way the one in Michigan was handled, and the results obtained at Ann Arbor are not to be expected.

Perhaps the provincial conferences lend themselves more to the Michigan approach. Generally, with fewer members and no wives in attendance, they are closer to the purely education type of conference. I have not discussed the provincial conferences in detail because I am familiar only with the one in Ontario. This I consider to be like the C.I.C.A. conference, except for the differences just mentioned.

When considered as an educational medium, the Canadian Institute conferences may have some defects. They seem to lack skilled professional direction such as is available from university professors. Too many items are crowded into a short period. There may be too many social attractions. Perhaps the main criticism is that there is too little opportunity for participation by the members. Most of them are not used to sitting in lectures and get restless after a short time. They like to participate in discussions and to express their views. In his paper on "More Professional Education" (CCA, December 1959), Professor L. G. Macpherson stated that "enough experience is

available to make possible resident study conferences which could be such stimulating and rewarding events that the demand would steadily expand".

As usual, the draft of this column was referred to several leading accountants. Many of them disagreed with my criticisms of our Canadian conferences. One summarized his views as follows:

"The provincial conferences can, with slight modifications, be made most useful vehicles for continuing education. If we are prepared to concede a few hours for the annual meeting and an inspirational talk, we have a good setting for a study conference. It would not be difficult to develop something fairly close to the Michigan plan. On the other hand C.I.C.A. conferences are different. Because of geographical factors and the time of the year fixed for these meetings, they have a strong social aspect. They are a sounding board for 'national policy', 'promotional' and 'public relations' matters affecting our

profession. However, there is still some useful education at these conferences."

Practical Program

As a practical matter, what can the practising accountant do today? He can read magazines and other literature, and attend the Institute conferences. If he is energetic, he can go to conferences in the United States where Canadians are always welcome. He can also attend lectures offered by other organizations and universities. Probably that is more than most of today's accountants are attempting. Those in larger firms have additional facilities within their own organizations for keeping up to date, including manuals, partner and staff meetings.

Perhaps the increasing complexity of accounting will force a revolution in the approach of the practising accountant to his continuing education. That is the problem the C.I.C.A. committee is studying. It will be interesting to hear what it has to report.

BY PETER C. BRIANT, PH.D., C.A.

Current Reading

MAGAZINE ARTICLES

AUTOMATION

"ORGANIZATIONAL CONSEQUENCES OF EDP" by Gardner M. Jones, *Business Topics*, Autumn 1959, pp. 23-27.

The development of a complete electronic data system is a long-term process requiring close collaboration between departments throughout a business. The controller's staff probably has more experience than any other group in acquiring and distributing information across departmental lines. The administration of the data processing activity, therefore, should be under the controller rather than under an operating division. That the centre is of sufficient importance to justify its standing as an autonomous agency is to be doubted. EDP systems may thus lead ultimately to increased importance of the controller in the corporate organization.

In keeping with the broadening responsibilities of his staff, some reorganization of the controller's division will be necessary. Duties may be realigned, for example, in an organization consisting of a group for each of systems and procedures, budget and planning, reports and audit, as well as an operating group. All groups would work closely with one another and with the production, sales and treasury departments.

The operations group would include analysts, programmers, coders

and machine operators for the EDPM and for data preparation equipment. It might also include individual information-supplying clerks in various locations. A clerk in the receiving department of a manufacturing plant, for example, might be a part of the operations group and be stationed in the receiving department to record by machine the original transactions occurring there.

Branch plants might include a very small data staff to collect and transmit information and to receive information back from the central processing unit for distribution locally. There would be no cost accounting department, payroll department, or books of account at the branches.

As electronic methods are applied to accounting areas, accounting staffs will be upgraded. The skills necessary for systems work, budgeting, schedule making and analysis command prices higher than are customary in routine accounting assignments. Almost every man, outside of the clerical workers and machine operators in the operations group, becomes a higher rated specialist of some sort.

"THE PROBABLE EFFECTS OF AUTOMATION IN THE OFFICE" by M. H. Jones. *The Australian Accountant*, November 1959, pp. 642-646.

The systems man, designing methods for utilizing new equipment, soon finds that the dividing lines between office departments become hazy, and

that electronic data processing has the power to cut completely across departmental lines.

The ability of data processing to serve business administration and operations calls for a new concept of business organization, as much of the clerical work carried out in operating departments must be transferred to the data processing centre. Accounting and production files, for example, will be consolidated.

This centralization will apply also to branch records. Some fear this form of centralization will reduce the records available to branch offices and thus impair to some degree the service available to customers. However, the speed of processing may offset to a large degree any temporary inconvenience.

The development of audit programs which will provide adequate checks on the work of the highly mechanized office is going to require thought and a knowledge of the specific forms of mechanization used by clients.

To meet the new situation, the auditor will need a detailed knowledge of the system in use and a considerable knowledge of the equipment itself so that he will know how test transactions can be run, how accuracy checks may be used in the system, and the feasibility or otherwise of special runs for audit purposes. The day may even come when the auditor will have to have a knowledge of the art of computer programming.

The auditor's responsibilities remain unchanged, but his techniques will have to be adapted to the new age.

MANAGEMENT

"CONTROL: A BRIEF EXCURSION ON THE MEANING OF A WORD" by E. S. L.

Goodwin. *Michigan Business Review*, January 1960, pp. 13-17.

Planning, organizing, directing and controlling outline the usually accepted analysis of what a manager does when he manages.

While there is general agreement on what is involved in planning, organizing and directing, there is no general agreement or clear disagreement on the meaning of control.

Control starts with observing and measuring, but there are management theorists who do not want to leave it at that. They assert that control necessarily involves doing something about any deviations from plan that observation and measurement reveal, and from this flows a great deal of confusion.

No one will deny that the information-getting element of control must be followed by action if control is to be of any use at all. So must thinking and planning. But this does not make action a part of thinking or execution a part of planning. Once we have agreed to analyze management into four component parts, it only clouds the analysis to maintain that one of these parts includes all of the other three. Yet this is what the control-means-action adherents maintain.

If a manager's information tells him that things are not going as planned, there are three categories of action that he can take: (1) modify his plan, (2) revise his organization, (3) issue some new orders. The first of these looks suspiciously like planning, the second is indistinguishable from organizing, the third is indisputably directing. Clearly, nothing but the original gathering and interpreting of information remains to be labelled "controlling".

A fourth thing that the manager can do is to dig up more information or reinterpret and restudy some that he already has. In this sense, one of the actions that results from control can be more controlling. But in any case the manager's controlling has been composed solely of the getting and treatment of information. What he does ultimately in the light of the information and aside from his treatment of it is always pursuant to some other aspect of managing, except in the special case where it looks back to more information-getting first.

Because of the confusion surrounding its meaning, the word "control" should be dropped from the list of elements of managing. In its place, we might substitute "measurement", "reporting", "comparison", or "supervision". One word that is perfect for the purpose is "surveillance".

PROFESSIONAL

"IMPROVING AUDITOR - CLIENT CO-OPERATION" by Ralph E. Wilgus. *The Journal of Accountancy*, January 1960, pp. 46-50.

The auditor and his client have two important common goals: (1) fairly presented financial statements, together with a justifiable, unqualified auditor's opinion thereon and (2) a reasonable cost of the audit.

If the auditor is to issue an unqualified opinion, he must perform certain major tests of inventories and accounts receivable. These tests should be planned to fit conditions as the auditor finds them and should be confined only to those which are necessary for him to arrive at a sound opinion of the assets involved. Otherwise, an unnecessary and undue burden may be placed upon the client's office, warehouse and factory opera-

tions without a corresponding increase in value to the client.

The client can cooperate with the auditor by instructing all employees to furnish any and all information requested by the auditor freely and without restraint. Management should let it be known that nothing is to be hidden that would pertain to the matters being reviewed by the auditor. The latter, for his part, should weigh very carefully the need for information requested and should be considerate of the client's employees.

The key to a reasonable audit bill is careful planning on the part of both the client's chief accounting officer and the auditor. Well in advance of the audit itself, the auditor should sit down with the client's representative and go over his program carefully. Such a review would produce numerous working papers and supporting data that could be prepared by the client for the auditor's use. Auditors waste too much time copying records or balancing records, all of which could be done just as well by a \$60 a week clerk.

Some auditors hesitate to show their working papers to the client. This is foolishness! There is no mystery about the information that is in the working papers. These figures come from the client's own records. Also, some auditors do not like to disclose just how much checking or testing they have done. This again is foolishness. They are not on trial. They do not need to justify their actions. These are matters of professional judgment which must be left to the auditor himself. Most of the accountants on the other side of the fence are not as ignorant about audit procedures as some public accountants think.

Once the auditor and client cooperate to achieve their common goals, the audit can be programmed more effectively. The client will do all the clerical work possible, and the auditor will concern himself with making such tests as are necessary to render professional judgment.

BOOKS RECEIVED

"Introduction to Mathematical Statistics" and Solutions Manual, by R. V. Hogg and A. T. Craig; pub. by The Macmillan Co. Ltd., Galt, Ont.; 245 pages (solutions manual 18 pages); \$6.75 (solutions manual free).

From the point of view of the average chartered accountant, the use of the word "introduction" in the title of this book may be somewhat misleading. The mathematical prerequisites for an understanding of the book would include a knowledge of advanced calculus together with related mathematics courses. For a reader possessing this background, however, the book is a most complete and masterful introduction to statistics, and provides a handy reference text for the more advanced specialist.

"Hire-Purchase Accounts and Finance" by H. S. Cook, J. A. Hermon and H. Pearse; pub. by Gee & Co. (Pub.) Ltd., London; 144 pages; 27/6.

The subject of hire-purchase (instalment-term selling on this continent) has recently become of great topical interest in the United Kingdom, and this work is written largely with the British business executive in mind. The authors apply the techniques of modern management accounting to the many specialized problems which face the executive handling hire-purchase business.

"Intermediate Accounting" (2nd ed.) by A. W. Johnson; pub. by Rinehart & Co. Inc., New York; 793 pages; \$8.50.

This text for second-year accounting students stresses the analytical and interpretive aspects of accounting. In the revised edition, the paramount emphasis is on "income", and special attention is given

to "valuation accounting" by showing the effect of accounting valuations on the income statement and the balance sheet. There is a generous supply of realistic test problems at the end of each chapter.

BOOK REVIEW

"Canadian Mortgages" by H. Woodard; pub. by Wm. Collins Sons & Co. (Can.) Ltd., Don Mills, Ont.; 400 pages; \$7.00.

There has long been a need in Canada for a book which brings together all the significant features of mortgage lending in each province. Mr. Woodard, drawing on his many years of experience in the field, has succeeded in producing both an easily readable text for students and laymen and a convenient source of reference and refresher course for mortgage administrators, lawyers and accountants.

After pointing out the great change that has taken place in the public attitude toward mortgages, from the days when a mortgage on one's house was unmentionable to the present when few properties change hands without mortgage financing, the author describes the procedures involved in mortgage lending and the pitfalls awaiting the unwary. He emphasizes that title to real estate is a provincial matter, and full weight is given to the special features of the law and practice in each province. Purposely omitted are the more complicated legal aspects and details of the many accounting systems in use for recording principle, interest, tax and insurance payments.

The two essentials of a mortgage loan are the credit worthiness of the borrower and the value of the property. Where a large volume is being processed, debt ratios and other

standards must be employed to reduce delays in handling and bring to light those applications needing special scrutiny. Assessing the value of the security involves a knowledge of land titles, forms of mortgages and appraisal methods. There are two main systems governing the registration of land ownership in Canada. The "Old Registry System" necessitates a solicitor wading through a mass of registrations to ascertain whether the proposed seller or mortgagor has the title he claims to hold. Under the "Land Titles" or "Torrens" system the registry office issues a certificate of title which is evidence of legal ownership. Appraising is largely a matter of judgment. While reference is made to special texts describing a number of rating systems, the basic requirement in this field is experience and familiarity with the locality.

These same two essentials of credit worthiness and value of security require safeguarding throughout the whole process of making the loan, taking security and accounting for payments. Several chapters are devoted to the step-by-step procedures that should be followed. Recent court decisions have shown what damage

can be done to the mortgage security of buildings under construction by claims filed under the Mechanics' Liens Act of the various provinces. The precautions to be taken against this contingency are dealt with at some length. Taxes must be watched, and several methods of handling instalment payments are reviewed. Insurance can trap the inexperienced with such items as co-insurance clauses and additional coverage taken out unknown to the mortgagee. Arrears must be tackled promptly since the first instalment missed is frequently the significant one and, if the matter is not rectified quickly, personal contact is essential. Foreclosures involve expense and delay, and the simpler quit-claim procedure offers advantages provided precautions are taken to ensure that the mortgagor is in a position to give clear title.

The book is written in a pleasant style with frequent sub-headings providing ease of reference and assisting the reader to identify the subject matter. The author keeps to the point in each section and gives cross-references to other chapters and books rather than distract the attention of his reader from the principal theme.

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Tax Review

PERSONAL CORPORATIONS (Contd.)

Distribution of Income

Once the net income of a personal corporation has been established, it must be apportioned to the shareholders who are deemed to have received their portion as a dividend on the last day of the taxation year of the corporation. The amount accruing to each shareholder in this manner is calculated by reference to the shareholders appearing as such on the last day of the taxation year, but is not necessarily divided amongst them equally on a per share basis, as might ordinarily be assumed. The net income must be divided in the proportion that the value of all property transferred or loaned to the corporation by the shareholder, or any person by whom his share was previously owned, is of the value of the property so acquired by the corporation from all its shareholders. The value of the property is the fair market value of all property received by the corporation from its shareholders valued at the date of transfer regardless of whether or not there is consideration (stock, notes, etc) for the transfer. Where the property of one personal corporation is transferred to another, the shareholders of the first corporation are deemed to have transferred to the second corporation the property that they transferred to the first corporation.

The foregoing formula departs from the basis for the division of earnings under company law as it effectively ignores the corporate body. It is worth observing, however, that while the income may be taxed in the hands of the donor of property, it may nevertheless accrue to the benefit of other shareholders. For example, a father might wish to transfer a part of his estate to his children, and accordingly would form a personal corporation of which he was a preference shareholder only, but sole contributor of assets. While he would pay tax on the entire income, whether distributed or not, the portion of the income that was not distributed would accrue to his children, the common shareholders, which enables him to transfer funds to his children without incurring gift tax.

Where a dividend is actually paid by a corporation that has always been a personal corporation, the dividend is not included in the shareholder's income. This permits such corporations to pay out capital gains or other non-income profits by way of cash dividends if desired, without the shareholders being subject to tax. Of course, this is contrary to the principles applied to any other type of company.

In the case of actual dividends from a personal corporation which in some previous year was not a personal corporation, they are tax-free if they do not exceed the income ac-

cumulated as a personal corporation, including income of the current year, but not capital gains or other non-income items. If the dividends exceed the income so accumulated, they are taxable to the extent that they are paid out of undistributed income earned after January 1, 1917 when the company was not a personal corporation. Once this undistributed income has been exhausted, pre-1917 income and capital gains may be distributed as tax free dividends. The calculation of the income accumulated as a personal corporation is relatively simple because it merely involves the addition, for the years in question, of the amounts deemed to be distributed to the shareholders and the subtraction of actual dividends paid. In this connection, however, it may be wise to note that in the computation of the income of a personal corporation, allowances are permitted for depletion upon dividends received by the corporation from certain mining, petroleum or natural gas companies. These allowances could be considered as additions to capital. If paid out as dividends, they could involve the shareholders in a tax liability where the corporation was not always a personal corporation. Conversely, the disallowance of certain expenses, such as provincial corporation taxes or donations, will permit the corporation to pay dividends in excess of its actual earnings without subjecting the shareholders to tax. This principle operates in the same way as the reduction of designated surplus in an ordinary corporation is accomplished through disallowed expenses.

Where the undistributed income must be calculated, the normal rules apply except that dividends paid in excess of the corporation's income while it was a personal corporation

are not allowed to reduce the undistributed income, except, of course, to the extent that the shareholders have paid tax thereon.

Where a taxable corporation was previously a personal corporation, it may distribute, tax free, amounts deemed to have been distributed while it was a personal corporation. However, capital gains which could have been distributed while it was a personal corporation are locked in once it becomes an ordinary taxable corporation.

If an ordinary corporation owns shares of a personal corporation it will be deemed to receive its share of the personal corporation income also. It would not be entitled to deduct the deemed dividend from its income, because the deemed dividend is derived from an exempt corporation. This applies whether or not the income of the personal corporation is derived from dividends. Dividends actually received from the personal corporation would, of course, be excluded from the income of the ordinary corporation in the same manner as individual shareholders.

The foregoing summary of the provisions of the Income Tax Act concerning distributions by personal corporations has been necessarily brief, and it is suggested that recourse should be had to the Act in those cases where the corporation has not always been a personal corporation, for the provisions are quite technical and detailed.

Deductions Available to Shareholders

If the individual shareholder of a personal corporation were to receive a dividend from a taxable Canadian corporation, he would be entitled to deduct 20% of the net dividend from

his income tax payable. This benefit is not lost where dividends from taxable Canadian corporations are received by a personal corporation. Such dividends form a part of the corporation's income and the proportion of such dividends to total income establishes the portion of the deemed dividend that the shareholders are considered to receive from taxable Canadian corporations.

The Act provides a similar method whereby the shareholders may deduct from their personal taxes an allowance for foreign taxes paid on income received by the personal corporation.

If part of the equity of the shareholders of a personal corporation is in the form of interest-bearing notes, the interest thereon is deductible from the corporation's income. This results in a smaller deemed dividend at the year end, but where the income of the corporation includes dividends from taxable Canadian corporations, the 20% dividend credit which the shareholders may claim will be reduced. This arises from the fact that the expenses of the personal corporation, including interest paid, must be prorated between dividend and other income for the purpose of computing the net dividends from taxable Canadian corporations deemed to be received by the shareholders. The same situation occurs with respect to foreign tax credits, and it therefore appears obvious that personal corporations should keep interest expense to the minimum. The interest received by shareholders is taxed as such and is not considered a dividend.

It is also observed that shareholders who receive interest upon their contribution of assets to the personal corporation will be taxed upon a

larger amount of income *vis-à-vis* the shareholders whose entire investment in the company is in the form of capital stock. This arises from the fact that the net income is apportioned to these shareholders even though they may have received their fair share through interest.

As previously mentioned, it is the practice of the Taxation Division to permit shareholders of a personal corporation to deduct their pro-rata share of the charitable donations made by the personal corporation when computing their personal taxable incomes.

Provincial Taxes

Personal corporations located in Ontario or Quebec will be exempt from provincial income taxes provided that the controlling shareholder is resident in the province in question. If he is not so resident, the corporation will be treated as an ordinary corporation for provincial purposes, even though it is still a personal corporation for federal purposes. This usually is a serious plight since no federal credit or deduction is allowed, either to the corporation or to its shareholders, for provincial income taxes. Both Ontario and Quebec impose a place of business tax upon personal corporations, and Quebec also levies a capital tax. A deduction from the income of personal corporations for these taxes is allowed for provincial purposes, but is only allowed for federal purposes to the extent that the capital and place of business taxes exceed 9% of the taxable income of the corporation. It has previously been noted that no computation of taxable income for a personal corporation is necessary as it is the net income which is deemed to be dis-

tributed. However, in order to calculate the amount of corporation taxes deductible, it is necessary to establish a taxable income as though the corporation were an ordinary company, and thus dividends received from taxable Canadian corporations and donations must be deducted from the net income. Provincial corporation taxes, that is capital and place of business taxes, may then be deducted to the extent that they exceed 9% of this notional taxable income. In practice, this situation will only arise where all, or almost all, of the personal corporation's income is derived from dividends from taxable Canadian corporations.

Returns

The controlling shareholder of a personal corporation must file, with his annual tax return, the financial statements of the corporation. Failure to do so may result in his being assessed for double his proportion of the income. It would seem, however, that such corporations are also required to file the usual corporation income tax forms, and an acceptable practice has been evolved whereby the personal corporation files form T.2 with the financial statements and a schedule, or T.5 forms, showing the income allocated to each shareholder. The various shareholders then merely pick up their portion of their own returns. Because of the strict wording of the Act which calls for the doubling of the major shareholder's income from the personal corporation if financial statements are not attached to his personal return, it is suggested that such shareholders should attach such statements to their returns or file the corporation T.2 returns at the same time in the same envelope.

Section 105

A personal corporation which has not always been a personal corporation may elect to pay a 15% tax on its undistributed income on hand at the end of its 1949 fiscal year, and thereafter on an amount equal to dividends paid in 1950 and subsequent completed fiscal years when it was not a personal corporation.

Where a personal corporation acquires control of another Canadian corporation, the controlled corporation may elect to pay a 15% tax on its 1949 undistributed income and on an amount equal to dividends paid since 1950 before and after it became a controlled corporation.

Gifts

Although a personal corporation is subject to gift tax, it may make an annual gift of \$4,000 and any number of gifts of less than \$1,000 per individual annually, all free of tax. This suggests that it may be advantageous for a personal holding company to be qualified as a personal corporation, or for such a corporation to be formed, in the case of an individual intent upon reducing the value of his estate by way of gifts during his lifetime. In this manner, additional gifts may be made at no tax cost, or, if larger gifts are desired, at a smaller tax cost because of the division of the gifts between the shareholder and the corporation. Care must be exercised, however, as gifts made within three years of the controlling shareholder's death can now be included in his estate, for federal purposes, if made by a corporation which he controls to anyone related to him by blood, marriage or adoption. Moreover, the provincial succession duty authorities might include such gifts, whenever made.

Non-Residents

All dividends deemed to be paid to non-resident shareholders by a personal corporation are subject to the 15% non-resident tax. The general rule is that all dividends, whether deemed or actual, are subject to the tax except those that are not required to be included in the shareholder's income by virtue of the provisions relating to personal corporations. If non-residents acquire control of such a corporation, it will cease to have that status; nevertheless, dividends actually paid out of personal corporation earnings will be free of tax.

Death of Principal Shareholder

Depending upon the circumstances, it may be advantageous to change the company's year end to coincide with the date of the death of the principal or controlling shareholder. In this manner, the deceased will be deemed to have received on the day of his death the income of the personal corporation to that date. If the year end is not changed, the income for the entire fiscal period will be divided amongst the new shareholders according to their deemed property contributions. It may be that the new shareholders are in such a relationship that the company no longer qualifies as a personal corporation, in which case the income for the entire year will be taxed at corporate rates. Depending upon the type of income of the corporation and other factors, this may or may not be an advantage.

Purpose of Personal Corporation

There are several advantages to be obtained by an individual and members of his family in forming a corporation to hold their personal securities. The management of the com-

pany and the assets vested in it may be conveniently delegated to others. The corporation does not go out of existence on the death of its principal shareholder, which permits the estate of the deceased to be dealt with more expeditiously than might otherwise be the case. For example, where the assets of the corporation are situated in different countries or provinces, no question of multiple death duties arises. The difficulties of conflicting rules of situs are avoided and estate tax or succession duty returns do not have to be filed in several jurisdictions. The funds of the corporation are available to the estate or beneficiaries of the deceased and the usual expense and delays of transferring securities to the estate or the beneficiaries are avoided.

In addition to the advantages mentioned, a personal holding company may be formed to freeze the value of the principal shareholder's estate or to retard its growth. Often this is accomplished by arranging for the principal shareholder to own non-cumulative redeemable preferred shares of the corporation and to have his heirs own the common stock. Although he may be taxable on the income of the corporation on the basis of capital contributed, the appreciation in the value of the company's investments accrues to the benefit of the common shareholders. Also, if a portion of the income of the company is not paid out as dividends, it accumulates for the benefit of the common shareholders.

Where an individual controls a profitable operating company, it may be to his advantage to transfer his shares to a personal holding company because the undistributed income accumulated while one company is a

subsidiary of another may be received by the parent company free of tax, so long as it is not a personal corporation. Should it be necessary to dispose of the shares of the operating company the existence of the holding company may facilitate the transaction considerably. By acquiring the shares of the parent instead of the subsidiary company a corporate purchaser may avoid a designated surplus problem. Alternatively, the holding company might be used in conjunction with an investment dealer to extract the surplus of the subsidiary tax free and thereby reduce the selling price of its shares. This latter technique may also be used to good advantage on the death of the principal shareholder, to obtain funds tax free for the payment of death duties.

Because the income of a personal corporation is deemed to be distributed at its year end, where such a corporation is to receive a large dividend in a given year or for other reasons, it is often desirable to disqualify it as a personal corporation. Usually this can be done by having it carry on an active business.

One of the peculiarities of the law in respect of personal corporations is that rental income received by them is considered investment income unless the corporation is carrying on active business, in which case it would be no longer a personal corporation. If the rental income were received directly by the individual shareholders of the corporation, it would be earned income and therefore escape the investment surtax payable on rental income which is received through the personal corporation. Another reason why it is sometimes considered undesirable to have

depreciable property held by a personal corporation is that if it is held by an individual, the person acquiring the property by inheritance is deemed to have acquired it at a capital cost equal to its fair market value at the time of death. If the property is held by a corporation, no increase in value will be recognized for purposes of calculating capital cost allowances.

The capitalization of a personal corporation depends primarily on what the shareholders wish to achieve. Provided cognizance is taken of the consequences of using interest-bearing obligations, the capital structure may be designed to fit any given situation. However, it should not be overlooked that where property is transferred to a corporation and capital stock received as consideration, gift tax complications may arise if the value of property is either more or less than the value of the capital stock or other consideration.

THE LAW

Canada-Finland Tax Convention

The Convention between the Government of Canada and the Government of the Republic of Finland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income is now in force, the instruments of ratification having been exchanged on December 31, 1959. According to the provisions of the treaty, it takes effect as of January 1, 1958 and those concerned would be well advised to ensure that, where applicable, the provisions are applied as of this date. The Convention contains the usual provisions concerning industrial and commercial profits, personal and professional services, the exemption of profits from ships and aircraft, etc.

Students Department

"What's in a Name" Contest

From time to time accountants have been accused of being stodgy individuals, unwilling to make drastic changes. It occurred to me that the present heading of this department may not be entirely appropriate because of the implication in its name that it is designed solely for students registered in the Institute's course of instruction. This is not the case. It is the panel's hope that this department will be of interest to *all* students of accounting, including members of the profession. However, the panel members have been unable to suggest a better heading, and it occurred to us that possibly our readers may have appropriate names to call it (using Parliamentary language only).

If there is to be a change in the department's name, we would like one that would be fully descriptive of the department's widest purposes and, if possible, one that is imaginatively intriguing. With this in mind, we are very pleased to announce the "What's in a Name" contest to find the best name for the Students Department. The prize for this contest has not yet been decided; it may be the privilege of whistling in the presence of the editor of this department; it may be the privilege of taking the Income Tax Act and Regulations into the final examination; it may even be money (although this is doubtful). It will allow all entrants to add, after their name, the significant initials

C N N S D C C A (Contributor, New Name for the Students Department of *The Canadian Chartered Accountant*). The winner will be allowed to put after his name, the letters W C N N S D C C A (Winning Contributor of a New Name for the Students Department of *The Canadian Chartered Accountant*).

The rules for this contest are:

1. All titles suggested should be 25 words or less.
2. All entries must be postmarked on or before April 30, 1960.
3. Entries are limited to registered students, members of the profession, subscribers to the magazine, and anyone else who wants to enter.
4. All entries should be legible and not presented in the handwriting usually found in working paper schedules.
5. No more than ten entries per person will be allowed.
6. The decision of the judges is final. In the event of duplicate entries the entry with the earliest postmark, or the one with the largest sum of money accompanying it, will be declared the winner.
7. Please address all entries to:

The Editor, Students Department,
The Canadian Chartered Accountant,

69 Bloor St. E., Toronto 5, Ont.

Let's hear from you !!

Conduct in Clients' Offices

by D. C. R. Horne, C. A.

Although it remains for the employer to advise his students of his requirements respecting their conduct, there are certain matters which it is felt all members will agree should be considered almost standard procedure everywhere. Local conditions and other factors may well have a bearing on these requirements, and where the latter differ from the following suggestions, no students should take the inference that the standards laid down for him are in any way out of line or incorrect. In all matters, however, where the student is lacking in instructions as to his conduct, he should not hesitate to ask for direction on any question about which he remains in doubt.

We all know that our initial impressions of people we meet are strongly influenced by their attire and grooming according to the occasion. Each day we look forward to meeting new people, and we should be prepared accordingly from the point of view both as an individual and as a representative of the firm. Admitting to one much-imposed attribute briefly, we should adopt conservatism as the keynote of attire in business hours. The question of dress enters the conduct picture mainly during summer weather when the natural inclination is to doff jackets and roll up sleeves, and perhaps even to slacken collar and tie. Good commonsense should prevail where a choice is available, but in no circumstances should we do what our client's staff are not permitted to do.

That last statement should, in fact, be considered as the guiding thought concerning conduct on the job, in respect of smoking, removal of jackets,

and breaking off for coffee. In the matter of a coffee break where one is granted the client's staff, we should not assume that the client's executives would look with approval on our taking this break. Remember that in many cases our fees are determined by the hours spent on the assignment. It is always the best policy to ask for direction. Of course, if coffee breaks are forbidden as an overall policy of your employer, the question does not arise.

Most clients are happy to permit us the use of their telephones, but courtesy (if nothing else) dictates that we restrict their use for personal calls to matters of quite some urgency and importance. Such calls should be as brief as possible, and never long distance!

Our conduct with the client's staff members must be irreproachable at all times. Be human, friendly, and courteous, but do not engage them in conversation unnecessarily. Do not offer criticisms of the client's employees, his operations or systems of accounting, nor of your employer or our profession. If you have comments of this nature, make them to your senior.

There are seasonal occasions, such as Christmas, when the client may wish to extend you his goodwill, expressed perhaps as a gift or an invitation to attend his staff party. In regard to gifts, make it a point to determine early your employer's policy as to the acceptance of gifts or favours at any time, and if you do attend the staff function, do not feel you have licence to dispense with all rules of conduct.

Never ask a client or his staff for a personal favour or privilege, for such may later serve to reflect on your

independence as auditor or accountant. The cashing of a personal cheque at a client's office is a good example of a favour that should never be asked.

For his additional guidance, a student should ascertain what procedure he should follow respecting queries during the examination of documents, how to approach the client's staff for additional information, and the observance of client's office hours where they differ from his employer's.

In performing an audit, we are necessarily in the position of checking the work of other people, and human nature often does not take kindly to being checked. It is easy to imagine the result when any air of superiority or authority is assumed by an auditor in normal circumstances.

Exemplary conduct is an essential attribute. When absent, it can destroy even the most excellent reputation for technical competency. Do not let poor conduct impede your career.

* * * *

PUZZLE

(Contributed by Mr. Horace E. Madore,
C.A., Montreal)

The percentage of profit (before deducting fixed costs) to sales revenue of A. Co. Ltd. was 6.4% for the year ended December 31, 1955.

At a meeting of the salesmen, it was resolved that in order to meet competition, a reduction in the selling price of all goods should take place, and that such reduction should be 2-3/8% for the whole year 1956.

One of the directors then asked by what percentage should the number of units sold during 1956, with prices thus reduced by 2-3/8%, exceed the number of units sold in 1955 in order to obtain the same amount of profit

before fixed costs, it being assumed that variable costs per unit sold remain constant.

What is the answer to his question?

(The solution appears at the end of this month's Students Department.)

* * * *

AUDIT CASE

In the course of their annual audit of a Canadian limited company, a firm of public accountants discovered that the inventory was valued at cost, which was significantly in excess of current market. The inventory was, and had always been, described on the balance sheet as being valued at the "lower of cost or market". Upon investigation, it was discovered that this situation was the result of many items of inventory gradually becoming obsolete and unsaleable. Unfortunately, this was not discovered until several years after the market value of the inventory had begun to decline below cost, which meant that for several years the auditors had given an unqualified report on statements that contained overstated profits and inventories.

The facts of the matter were brought to the attention of the management by the auditors who suggested that the inventory be written down to market in the current year. The management opposed an immediate adjustment for the following reasons:

(1) Management shared in the company's profits. In the years when profits were overstated, the management had been paid more than they should have. The current year was a loss year so there was nothing for management to share. Therefore, if the inventory was written down in the current year, the overpayments to management in respect of profits in

previous years would not be offset by a reduction of any current share.

(2) The company was a wholly-owned subsidiary of a foreign corporation, and its statements were consolidated with those of its parent. The overstatement of inventory, while significant in the statements of the subsidiary, would not be significant in the consolidated statements.

The management offered to make the necessary adjustment in the next profit year.

The auditors insisted upon an immediate adjustment, debiting an account receivable from the management for the amount overpaid to them, debiting surplus for the remainder of the overstatement of profits of previous years and crediting inventory for the amount of its overvaluation. If the management refused to make this adjustment, the auditors indicated that they would qualify their report accordingly.

In discussing the matter with management officials, the auditors pointed out that the fact that the error was not discovered sooner was unfortunate, but it could not be allowed to influence the action taken now that it had been discovered. An error must be corrected as soon as it is known. The overpayments to management did not have to be offset against underpayments in respect of profits of later years. An account receivable could be set up immediately and collected in one of several different ways. The fact that the company's statements were to be consolidated with those of its parent was not relevant; the auditors were reporting on the statements of the subsidiary, not those of the consolidation.

(Audit cases such as the one above are contributed by practising accountants with

a view to providing material of interest and assistance to students. The facts of the case have been edited so that the identities of the client and the auditor are disguised.)

ACCOUNTING AND AUDIT PROBLEM

What adjustments, if any, should be made in the accounts of a mining company which discovers that its ore reserves are greater than the original estimate, on the basis of which depletion allowances have been charged for several years.

(We invite readers' opinion as to how this transaction should be handled and presented. The facts have been edited to disguise the identity of the company concerned. A further discussion of this problem will be published in the May issue of the Students Department.)

TREATMENT OF JANUARY'S PROBLEM

Dealing with the problems as they were raised in the January issue, the recommended handling of this situation is:

(1) The amount and nature of this transaction should either be shown separately in the financial statements or disclosed in a footnote. It could probably be handled most clearly and easily as a footnote.

(2) If no disclosure of any kind is made in the financial statements, then reference to the transaction, indicating its nature and effect on the statements, should be made in the auditor's report. This would be so, whether or not the client wanted such a reference made.

If there appeared to be a bona fide sale at a reasonable price there can be no valid objection to a transaction of this kind, *provided*:

(a) the management of the client company had good reasons for selling the shares in this way,

(b) the officer concerned had no direct influence on the company's decision, and

(c) there is adequate disclosure of the transaction in the financial statements.

A transaction of this type is sufficiently unusual and subject to various internal pressures that all of the above factors would have to be cleared to the auditor's satisfaction before he could give an unqualified report.

If items (a) and (b) only were satisfied, the deficiency in disclosure could be handled by the additional information being given in the auditor's report which, in this case, could still be considered as unqualified. If, however, either or both item (a) or (b) were not satisfied, then the auditor should qualify his report.

It is difficult to imagine how item (c) could be absent if the auditor was to be able to satisfy himself as to item (a).

There is also the difficulty of deciding, in the absence of a free market, what is a "reasonable" price for a block of shares that constitute a controlling interest in a company. If he is satisfied that the price is not unreasonable, the auditor probably does not have to decide if it was "reasonable"; he can content himself with requiring enough disclosure that the shareholders of the investment company can, if they want to, debate this to their own satisfaction.

* * * *

NOTES AND COMMENTS

Probably as a result of the comments on examinations that appeared in the January issue, the following quotations from the answers to a provincial Institute's primary examination were sent in. While they could

be regarded as "howlers", the purpose of printing them here is not to amuse but to instruct. They illustrate the sort of loose wording that probably (we hope) does not represent the real thoughts of the students concerned, but is what they put on an examination paper, and undoubtedly lost marks on. These quotations all deal, in one way or another, with a description of the nature and purpose of depreciation in accounting.

1. "When a business shows a loss, depreciation may not necessarily be shown on the financial statements but it should still be recorded in the books."

2. "Depreciation is a bookkeeping entry and should be treated as such on financial statements."

3. "In accordance with good accounting practices the fixed assets are slowly becoming obsolete."

4. "Depreciation is an expense of doing business according to informed accounting circles."

5. "Depreciation is the factor which is used by accountants to vary profit and loss to:

- (a) a desired profit
- (b) a desired loss."

K.A.M.
* * * *

On another primary paper, a student had put at the bottom of a statement "Note: This sheet is plugged."

Such a comment could only be regarded by the marker as professionally insulting.

* * * *

As a closing "note", and without "comment", I hereby regretfully tender my resignation to the readers of this department as its editor (for six months — thus establishing a new indoor Canadian record). My person-

al regret on this occasion is more than offset by my personal and professional pleasure in being able to announce that Mr. Derek Horne has agreed to carry on at this stand. He will be ably assisted, as I have been, by the members of the panel of this department. In addition to the continuing challenge that preparing material for students provides, he and the panel hope to face the immediate prospect of a deluge of suggestions from the "What's in a Name?" contest.

* * * *

CORRESPONDENCE

Ed. note: In the January issue a letter from Messrs. R. G. Cooper and C. H. Bristol was published concerning a query by them on the suggested solution to question 3 from the October 1957 Accounting I Final examination. The reply to this letter aroused the following comments from a member of the department's panel who shall remain unidentified except to point out that he is Professor J. E. Sands, C.A., of the University of Toronto.

No par value shares do not have to be issued for nor recorded at any specified price, and in practice they may legally be and sometimes are issued and/or recorded at different prices at the same time. Thus the original answer was in accordance with what is apparently generally accepted accounting practice. In my opinion, however, the practice is not logically sound.

At any point in time the value of any one share of a given issue must be the same as the value of any other identical share. If twice as many shares are issued in exchange for one asset as for another at the same time, then twice as much has been paid for the one as for the other. The fact

that payment is made in shares rather than dollars makes no difference. Payment could be made in sea shells and the principle would be the same. If the units in which payment is made are identical, then two of them are worth twice as much as one of them.

It is true that the share issuer may make a good bargain in the one case and a poor bargain in the other, and in practice it must be acknowledged that company directorates sometimes make bad bargains deliberately to benefit certain individuals. But some shares are not less valuable than others because you paid too many of them for a given asset, any more than some dollars are less valuable than others because you paid too many of them for a given asset. The differences in prices paid relate to the cost of the assets purchased, not to the value of the individual share certificates issued.

The source of difficulty in handling transactions such as the one described is that frequently there is no active trading of the shares in a well developed and freely operating market at the time the transactions take place. Thus the true market value of the shares cannot be determined precisely but must be estimated. In this area there is room for legitimate differences of opinion. My own opinion is that the price paid to an outsider for a specific asset probably reflects the market value of the shares more closely than the price paid to shareholders in exchange for previously held shares.

I conclude, therefore, that Messrs. Cooper and Bristol are correct and that the original answer reflects a practice which is logically unsound and should be discouraged.

SOLUTION TO PUZZLE

Let X be the number of units sold in 1955

Let Y be the number of units sold in 1956

Let Z be the selling price per unit in 1955

Let A be the profit made in each of the years

In 1955 the profit before fixed cost was 6.49% of sales revenue

Therefore variable cost must have been $(1.0000 - 0.0649) XZ = 0.9351 XZ$

In 1956 the variable cost remained the same per unit and so they must have been
 $= 0.9351 YZ$

In both years sales revenue is equal to number of units times selling price.

Therefore in 1955 $XZ - 0.9351 XZ = A$

In 1956 $0.97625 YZ - 0.9351 YZ = A$

Therefore $XZ - 0.9351 XZ = 0.97625 YZ - 0.9351 YZ$

and $0.0649 X = 0.04115 Y$

$$\frac{Y}{X} = \frac{0.06490}{0.04115}$$
$$= 1.58$$

Therefore increase in sales will have to be 58%.



Alberta

Rexspar Minerals & Chemicals Ltd. has announced that H. G. Norman, C.M.G., C.A. has been elected a director of the company and named chairman of the board of directors.

D. J. Fraser, B.Com., C.A. announces the opening of an office for the practice of his profession at 633 Tegler Bldg., Edmonton.

British Columbia

F. C. Swallow, C.A. announces that his practice has been assumed by Messrs. Power, Bestwick, McDougall & Lavery, Chartered Accountants, of Nanaimo. In future the Parksville office will be carried on under the name of Swallow, Ilott & Co., Chartered Accountants, Parksville, with W. D. Ilott, C.A. as resident partner.

Fry, Rigsby & Co., Chartered Accountants, announce the admission to partnership of D. I. Johnston, C.A. Henceforth the practice of their profession will be carried on under the firm name of Rigsby, Johnston & Co., Chartered Accountants, from offices at 282 and 318 Reid St., Quesnel, with G. A. Rigsby, C.A. and D. I. Johnston, C.A. as partners in the firm.

Dick Chong, B.Com., C.A. announces the opening of an office for the practice of his profession at Ste. 3, 5684 Victoria Dr., Vancouver 16.

G. W. Read, C.A. announces the admission to partnership of J. O. Madsen, C.A. The practice will henceforth be carried on under the name of Read, Madsen & Co., Chartered Accountants, with offices at 1323 Lonsdale Ave., North Vancouver, and 516-736 Granville St., Vancouver 2.

Rickard, Crawford & Co., Chartered Ac-

countants, announce the removal of their offices to Johnson Bldg., 1st Ave., Williams Lake.

L. D. Barnes, C.A., L. McNicol, C.A. and L. M. Kershaw, C.A. announce the merger of the practices of Barnes, McNicol & Co. and L. M. Kershaw. Henceforth the practice of the profession will be conducted under the firm name of Kershaw, McNicol & Co., Chartered Accountants, with offices at 1201 Melville St., Vancouver 5.

R. L. Foster, C.A. announces the opening of an office for the practice of his profession at 4021 E. Hastings St., North Burnaby.

Chadwick, Potts & Co., Chartered Accountants, New Westminster and South Burnaby, announce the opening of a branch office at #5, 440 Victoria St., Kamloops. The resident partner is R. L. Buxton, C.A.

J. M. Dunwoody & Co., Chartered Accountants, announce the opening of a branch office at Rm. 1014, 736 Granville St., Vancouver 2. The resident partner is H. S. Sigurdson, C.A.

A. D. Stanley, C.A. has been appointed treasurer of the Vancouver International Festival Society.

G. F. Dunn, F.C.A. addressed the December 1959 meeting of the Port Alberni Canadian Club on "Some Aspects of Communism".

A. L. Taylor, C.A. has been appointed comptroller of Westminster Paper Co. Ltd.

Manitoba

The Great-West Life Assurance Co. has announced the appointment of H. L. Johnston, C.A. as manager, accounting, at its head office in Winnipeg.

Ontario

J. I. Hauer, C.A. announces the removal of his office to Ste. 3, 2491 Lawrence Ave. W., Toronto 12.

A. M. McIntosh, C.A. has been appointed secretary-treasurer of Edwards of Canada Ltd.

R. W. Cooke, C.A. has been appointed comptroller of National Steel Car Corp. Ltd.

W. D. Roberts, C.A. has been appointed comptroller of Lake Simcoe Ice and Fuel Ltd., Toronto.

Alex Farrell, C.A. has been appointed to the board of directors of Cabot Carbon of Canada Ltd., Sarnia.

B. M. Houpt, C.A. announces the removal of his office to Ste. 302, The Royal Bldg., 328 Adelaide St. W., Toronto 1.

Morrison, Sanderson & Co., Chartered Accountants, announce the removal of their office to Ste. 302, 11 King St. W., Toronto 1.

Stephens McLean & Co., Chartered Accountants, announce the removal of their offices to 1204 Canada Bldg., Windsor.

B. J. Bouris, C.A., H. A. Robinson, C.A. and J. E. Scott, C.A. have formed a partnership for the practice of their profession under the name of Bouris, Scott, Robinson & Co., Chartered Accountants, with offices at 394 Bank St., Ottawa.

Cohen, Perlman, Collins & Co., Chartered Accountants, announce the admission to partnership of B. C. Smith, C.A. The practice will be continued under the firm name of Cohen, Perlman, Collins & Co. with offices at Ste. 308, 88 Richmond St., Toronto 1.

Quebec

Marcel Rivard, C.A. has been appointed 2nd vice-president of La Survivance, Mutual Life Assurance Company.

R. E. L'Abbé, C.A. has been elected life governor of Notre-Dame Hospital in Montreal.

Saskatchewan

J. G. Wicjowski, B.Com., C.A. announces the opening of an office for the practice of his profession at 1850 Broad St., Regina.

OBITUARIES

We regret to announce the death of the following members:

BRUCE GEORGE MACKAY — age 25, who died on November 7, 1959, following an automobile accident in Nassau, Bahama Islands. He was born in St. Catharines, and as a student-in-accounts was employed by Harper, Tory & Co., St. Catharines, and Price Waterhouse & Co., Toronto. He was admitted to the Ontario Institute in 1959. At the time of his death, he was employed by Peat, Marwick, Mitchell & Co. in their Nassau office.

SAMUEL ALFRED GRAY CURRY—on January 24, 1960, senior partner of Curry & Co., Chartered Accountants, Vancouver. Born in England in 1889, Mr. Curry was raised in Saskatchewan and came to Vancouver in 1920. He was admitted to the B.C. Institute in 1925, and commenced practice shortly thereafter. He was for many years manager of the Lansdowne Park racetrack mutual department and was a well-known figure in West Coast golfing circles.

**INSTITUTE NOTES****ALBERTA INSTITUTE**

Memberships in the Alberta Institute were presented to 22 new chartered accountants from Edmonton and district by J. G. Duncan of Edmonton, president of the

Canadian Institute, at a ceremony on January 8 in the Northern Jubilee Auditorium.

In the evening the Edmonton Chartered Accountants Club sponsored a dinner and dance at the Macdonald Hotel.

B.C. INSTITUTE

Convocation: Sixty-six successful finalists received membership certificates at the convocation held at Brock Hall, U.B.C. on the evening of Friday, January 29.

Honoured guests included C.I.C.A. president J. G. Duncan, Dean E. D. MacPhee, D. R. L. Johnston, and convocation speaker A. E. Grauer, Chancellor of the University of British Columbia.

Special General Meeting: About 60 Institute members attended a special general meeting held in the Hotel Georgia Ballroom, Vancouver, on the morning of Friday, January 29. The meeting approved the repeal of the present by-laws pertaining to professional conduct and the enactment of amended by-laws. In addition, approval was given to the repeal of the code of professional conduct and the adoption of a code of ethics and rules on professional conduct.

The revised by-laws now provide for two bodies in addition to Council to deal with professional conduct matters. The Committee on Professional Conduct will henceforth serve primarily as a fact-finding body, while adjudication will be the function of the Professional Conduct Enquiry Board. The disciplinary measures of Council, previously effectively limited to the extremes of suspension and expulsion, have now been expanded to include admonishment, reprimand and fining of errant members.

The new code now includes a compilation of a fairly extensive set of rules codifying certain specific types of conduct not in harmony with Institute policy. The two concluding sections of the code relate to members carrying on management consulting work.

Committee on Attracting Students: A new 8-page pocket-size brochure entitled "Chartered Accountancy as a Career" has been published by the Institute.

The Committee on Attracting Students, under the chairmanship of Fred Chester, held a dinner meeting with high school counsellors from the Greater Vancouver-Lower Mainland area at the Terminal City Club on February 2. A similar meeting is planned for the Greater Victoria area.

The Institute will again sponsor two sessions of the Strong Vocational Interest Test for Grade 12 male U.P. graduates in the Greater Vancouver-Lower Mainland area on Wednesday and Thursday evening, March 16 and 17, in the Canadian Legion Gymnasium, 2655 Main St., Vancouver 10.

Fred Gingell and Harry Longstaff have undertaken the organization of speakers for high school vocational conference days in the Greater Vancouver area. Stewart Watt and S. J. Ladymar are active in the Greater Victoria and Vernon areas, respectively.

MANITOBA INSTITUTE

The Manitoba Institute announces the election to Fellowship of T. D. Poyntz, F.C.A. and W. W. Smith, F.C.A., both of Winnipeg. The honour was conferred in recognition of "conspicuous service to the profession".

ONTARIO INSTITUTE

Members Dinner: The 77th anniversary dinner will be held in the Canadian Room of the Royal York Hotel, Toronto, on Friday, March 11. The guest speaker will be John J. Robinette, Q.C., treasurer of the Upper Canada Law Society. The president of the C.I.C.A., J. G. Duncan, will present Canadian Institute Prizes to Ontario winners. Invitations and additional details have already been received by members.

Personnel Tests: In response to the growing demand for the use of the Institute's personnel selection test in the Kingston area, a centre was established there on February 1. Testing will be conducted by appointment with Professor E. J. Benson, C.A., Department of Commerce, Queen's University.

Second Annual Public Tax Forum—March 29, 1960 is planned as the date for a second tax forum, the first of which was such a success. W. I. Hetherington F.C.A. will act as chairman this year.

Letter to Practising Firms:

Auditors' Report for Companies Incorporated under Federal Statute

The C.I.C.A. Bulletin No. 17 on the auditor's report, issued in October 1959, suggests a standard wording which may be

(Continued on page 320)

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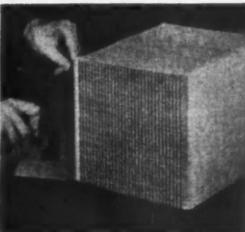
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(Continued from page 318)

modified to fill specific statutory requirements of the Companies Acts. It is generally agreed that a modification of the opinion paragraph is required for companies incorporated under federal statute.

It may be of interest to practising firms to know that a standard form has been developed and is being used by a number of firms. It is not suggested that complete unanimity within the profession is necessary, but some approach to uniformity is undoubtedly in the public interest. In the belief that members may find a specimen standard wording useful, one form which has been developed is here set out:

"In our opinion, and according to the best of our information and the explanations given to us and as shown by the books of the company, the accompanying balance sheet and statements of profit and loss and earned surplus are properly drawn up so as to exhibit a true and correct view of the state of the affairs of the company as at 19 and the results of its operations for the year ended on that date, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year."

T. MERRILEES
Registrar.
Toronto, Jan. 26, 1960

SASKATCHEWAN INSTITUTE

J. G. Duncan, president of the Canadian Institute, presented certificates and awards to the new chartered accountants of Southern Saskatchewan at a convocation held on January 19 in Regina. A. G. Woodward was the winner of the Watson Sellar prize for the highest marks in auditing, the Victor Ferguson Memorial prize for the highest marks in accounting, and the James Neilson medal conferred on the student obtaining the highest standing in the final examination. The last is only awarded in cases of outstanding distinction.

OKANAGAN-MAINLINE C.A. CLUB

A. George DesBrisay, vice-president of the Okanagan>Mainline C.A. Club, was host at a meeting of the club on January 30, at the Prince Charles Motor Inn, Penticton.

(Continued on page 322)

THREE NEW

C.I.C.A. Publications

OF OUTSTANDING INTEREST

FINANCIAL REPORTING IN CANADA

(3rd Edition, 1959)

A study of the accounting aspects of the annual reports of 300 Canadian companies for the years 1955 to 1958 inclusive. More than 60 tables and accompanying commentaries show the current trends in financial reporting. (Members \$4.00) **\$5.00**

**THE VALUATION OF PRIVATE
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A collection of important Canadian Chartered Accountant articles, this brochure is the most comprehensive and up-to-date discussion available on valuation and the treatment of goodwill. Among the topics covered are valuation of and accounting for goodwill; valuation of a privately owned business, a general insurance business, an accounting practice and a legal practice. Two chapters deal with valuation of a minority interest and earnings ratios in valuing companies. **\$2.00**

THE FUNCTION OF MANAGEMENT

This brochure contains 11 articles written by business executives for business executives to explain what management is, and to give a better understanding of the techniques and methods by which top management is able to discharge its responsibilities. There are chapters on organizing for effective management; the objective of management; sales, production and financial planning; personnel administration and management reporting. Four chapters deal with various aspects of control. **\$2.00**

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(Continued from page 320)

PRINCE GEORGE C.A. ASSOCIATION

A. M. Clark was elected president for the 1960 year at the annual meeting of the association. The secretary is C. A. Jeffery.

VANCOUVER ISLAND C.A. CLUB

Professor Robert Wallace addressed a luncheon meeting of the club at the Pacific Club on January 20 on "Victoria University—The Past, The Present and the Future".

C.A. CLUB OF VANCOUVER

N.A.T.O. exchange professor T. Wyller of Oslo University, Norway addressed the February 2 luncheon meeting on "Norway—before and after 1945".

The Hon. P. A. Gagliardi, Minister of Highways, will address the March 1 luncheon meeting to be held in the Hotel Georgia ballroom.

ONTARIO STUDENTS ASSOCIATION

Summer School in Toronto: The Council of the Association is happy to announce that arrangements have been made to hold a

summer school in Toronto. The course is restricted to students writing their final examinations in September.

Time: June 6 to June 24, 1960. A full-time course, involving approximately six hours instruction each day.

Instructors: The course coordinator will be Professor W. B. Coutts of the University of Toronto. He will be assisted by three other lecturers.

Fee: \$100.00 (excluding accommodation)

Enrolment: Application forms will be mailed on request. Only applications made on the prescribed forms will be considered.

To ensure the optimum benefit for the participating students, the enrolment will be limited to a maximum of 60 allocated on a "first come, first served" basis.

Purpose: This is not designed to be a cram course. It is primarily intended for those students who will have completed the correspondence course, who wish to review the course material and to learn the best way to present this knowledge in writing their examinations.

Accommodation: Students from outside Toronto are asked to make their own arrangements for accommodation. However, if this is not possible, the Students Association, on request, will arrange for accommodation to be provided at one of the university residences or fraternity houses.

Blazer Crests: A limited supply of Ontario Institute blazer crests is available to members of the Students Association at a reduced price of \$2.50. This special price is due to an error on the part of the manufacturer. The crests, although perfectly presentable, are not in accordance with the approved sample.

CHANGE OF ADDRESS

Members and students who change their address and advise The Canadian Institute of Chartered Accountants of such change should also notify their own provincial Institute.

The editor welcomes information for this column. News of members and provincial Institutes' activities received up to and including the 11th of the month will appear in the following issue of the journal.

CORRESPONDENCE



Burlington, Ont., Jan. 4, 1960.

ASCIERTAINMENT OF PROFIT

Sir: The article "Facing Facts in Financial Statements" by Donald Gordon, in the CCA, January 1960, obviously aims at stirring up interest in a subject that has also been discussed at the International Congresses of Accountants. To those who want to study the matter further, it should be of interest to read the following papers: Professor A. Goudeket, "Fluctuating Price Levels in Relation to Accounts", 1952, 6th Congress, London, England; G. L. Groeneveld, "Purpose and Significance of the Ascertainment of Profit", 1957, 7th Congress, Amsterdam, Holland.

Both gentlemen have put the theories into practice in their work for a big industrial concern with world-wide operations.

May I conclude with the following quotation from the paper by Mr. Groeneveld:

"It [the customary use of the historical

cost price] leads to capricious results in the profit calculation and thus creates a sphere of uncertainty in which provisions for contingent risks in the widest sense are considered to be essential elements of profit determination. . . . The historical cost price is an amount which expresses a fact from the past; it gives a figure that had a meaning at the moment of buying, but it is of no use for the ascertainment of cost and income in later periods. . . . The replacement value on the other hand is the value at the moment at which the valuation is made, reflecting the value attached by the economic society to the goods at the moment of exchange. . . . When the profit is determined in conjunction with this method it meets the requirements of both producer and society."

K. GERHARDT

Editor's Note: Mr. Gerhardt is a member of the Netherlands Institute of Accountants and is now a resident of Ontario.

SIXTH SUMMER SCHOOL IN ACCOUNTANCY McGILL UNIVERSITY, MONTREAL MONDAY, MAY 9, Through FRIDAY, JUNE 3, 1960

In view of the change of Chartered Accountants' examination dates, the school will be held in May, 1960, instead of in July.

As always, the school is intended to integrate and complete the studies of students for their professional accountancy examinations. Residence on the campus is required, throughout the period of the school, this being an essential part of the university life to which the student is to be introduced.

The first aim is to educate broadly and intensively in accounting theory and principles. The syllabus followed by the two divisions of the school will be that of the Intermediate and Final Chartered Accountants' examinations, respectively.

Classes will be held for six hours each day, from Monday through Friday, with the week-ends free. The school will be under the direction of Professor Kenneth F. Byrd, with professors of the School of Commerce and other universities assisting in the lecturing.

Apply promptly to the Summer School in Accountancy, School of Commerce, McGill University, Montreal, Quebec.

SWEETNESS AND LIGHT

THE REAL LOWDOWN

One of the paradoxes of modern living is that as the average height of human beings has increased, the height of the furniture and automobiles that are supposed to accommodate them has decreased.

One Saturday evening recently, a group of people in their mid-thirties sat around the living-room of a ranch style bungalow in Suburbia. All of them had been youngsters when vitamins first became a household word. Their mothers made them drink orange juice every morning and saw to it that they ate leafy green vegetables regularly. Some had put away extra portions of spinach because Popeye was their hero. As a result, they sprouted up and many eventually passed the height of their parents. Surveys by clothing manufacturers found that as a whole the generation was about two and a half inches taller than the previous one, and by the looks of things would produce children who would be as much taller again.

But as they sat around the living-room that evening, the group had something else in common. Without exception, they were all sitting on something which did not come close to fitting the adult human frame. They found the backs of the chairs and chesterfield sliced off about two inches below the shoulder blades, leaving no support for the part of the anatomy above the chair line, no way to relax the upper spine. One man stealthily rested his head against the wall when he thought no one was looking, and hoped his hair tonic would not leave a mark. The others just had to squirm into the most comfortable position possible and sigh for the big wing chairs in their parents' homes.

The furniture designers could not have had grown-up North Americans in mind either, when they established the distance from the seat of the modern chair to the floor. At least, it bore no relationship to the measurement from the heel lift to the

knee joint of any of the group, except the host's 12-year old son. There was always an excess of several inches of leg and nowhere to put it.

Looking around the home, the other pieces of furniture were the low-down successors of more imposing pieces owned by our shorter forebears. The tea-wagon had given way to the coffee table, now so low that it could act as a footrest more effectively than as a convenience for serving coffee. The buffet and china cabinet had been cropped by several inches. And the chesterfield had taken a beating both ways. Not only was it lower, but had also been split into sections breadthwise, no doubt to keep the man of the house from getting too much solid comfort if he stretched out for a Sunday afternoon snooze.

Of course, the people visiting this home must have been resigned to the low-high ratio before they arrived. For they all came in late model cars that were just as disproportionate.

One girl thought her boy friend was excessively polite because he always took off his hat before getting into his car, until he mentioned that his head bumped the roof if he did not. After all, the automobile dealer had told him, what else could be expected when he was six feet tall!

At that he was lucky compared with the misfortunes of some public figures. Controller William Allen of Toronto drove up to the City Hall in a cab one day and found himself trapped because the door would not clear the curb. Another prominent person was crawling out of a new car recently when the top of the door frame caught the back of his trousers, with disastrous results best left undescribed.

As a matter of fact, there is no need to go into more detail on any of these troubles. It is sufficient to note that they are all caused by low living, which to this writer seems the height of stupidity.

J.V.

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C.A. OR C.P.A. under 40 for head office of insurance company. An exceptional opportunity for the right man. Must be managerial calibre. Forward full details as to age, height, weight, educational and practical background to Box 994.

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